

FINDINGS OF FACT, CONCLUSIONS
OF LAW, AND ORDER

TABLE OF CONTENTS

PROCEDURAL HISTORY	1
I. INITIAL PROCEEDINGS	1
II. PARTIES AND REPRESENTATIVES	2
A. Intervenors	2
B. The Company	2
III. PUBLIC HEARINGS AND PUBLIC TESTIMONY	2
IV. EVIDENTIARY HEARINGS	3
V. OTHER RELATED DOCKETS	3
A. The MAC Complaint, Docket No. G-008/C-91-942	3
B. Minnegasco/Midwest Exchange of Assets, Docket No. G-008,010/PA-93-92	4
VI. THE SETTLEMENT AND STIPULATION	4
VII. PROCEEDINGS BEFORE THE COMMISSION	4
FINDINGS AND CONCLUSIONS	5
VIII. JURISDICTION	5
IX. FURTHER ADMINISTRATIVE REVIEW	5
X. THE COMPANY	5
XI. BURDEN OF PROOF	6
XII. TEST YEAR	7
XIII. THE SETTLEMENT AND STIPULATION	7
XIV. SETTLEMENT MODIFIED AND ACCEPTED	8
A. Structure and Content of the Settlement	8
Financial Issues	8
Rate Design Issues	9
B. Commission Action	9
XV. STIPULATED ISSUES RESOLVED	10
A. The Stipulated Issues	10
B. Summary of Commission Action	11
C. Incentive Compensation Tracker Established	11
D. External Funding of FAS 106 Obligations Required	13
1. Factual Background	13
2. Position of the Parties; the Stipulation	13
a. Minnegasco	13
b. The Department	14
c. The Stipulation	14
3. Commission Action	14
XVI. FUTURE FILINGS REQUIRED	15
A. Hypothetical Versus Actual Capital Structure	16
B. NorAm's Financial Condition Vis-a-Vis Minnegasco	16
XVII. REMAINING CONTESTED FINANCIAL ISSUES	17
A. Good Will	17
1. Introduction	17
2. Comments of the Parties; the ALJ	18
a. Minnegasco	18
b. MAC	18
c. The RUD-OAG	19
d. The Department	19

	e.	The ALJ	19
3.		Commission Action	20
	a.	Summary of Commission Action	20
	b.	Commission's Authority to Find Value in Good Will and to Impute Revenue for an Affiliate's Use of Good Will	20
	c.	In This Case, Should the Commission Impute Revenue to Minnegasco for the Nonregulated Appliance Operation's Use of Good Will?	22
	i.	The commission disagrees with the five reasons offered by the ALJ for a finding that revenue should not be imputed	22
	ii.	Conclusion	24
	d.	The Value of Good will to be Imputed	24
	i.	There is positive value to Minnegasco's good will	24
	ii.	The value of good will is one percent of revenues	25
B.		Cost Allocations for Gas Leak Checks	26
	1.	Factual Background	26
	2.	Positions of the Parties	26
	3.	Commission Action	27
XVIII.		OTHER FINANCIAL ISSUES	27
A.		Management Audit	27
	1.	Department and ALJ Recommendation	27
	2.	Commission Analysis	27
B.		Test Year Financial Information	28
C.		Conservation Cost Recovery	29
D.		Refund Plan	29
XIX.		REMAINING CONTESTED RATE DESIGN ISSUES	30
A.		Forecast	30
B.		Class Cost of Service Study	30
	1.	Introduction	30
	2.	Allocation of Conservation Improvement Program (CIP) Project Costs	31
	a.	Positions of the Parties; the ALJ	31
	b.	Commission Action	33
	3.	Allocation of Distribution System Capacity Costs	33
	a.	Position of the Parties; the ALJ	33
	b.	Commission Action	35
	4.	Allocation of Peaking-Plant Operating and Maintenance (O&M) Costs	36
	a.	Positions of the Parties; the ALJ	36
	b.	Commission Action	37
C.		Revenue Apportionment to the Customer Classes	37
	1.	Minnegasco's Proposal	37
	2.	Positions of the Parties; the ALJ	39
	a.	The Department	39
	b.	The RUD-OAG	39
	c.	MEC	39
	d.	ALJ	39
	3.	Commission Action	40
D.		Rate Design for the Large Volume Dual Fuel (LVDF) Customer Classes	41
	1.	Introduction	41
	2.	Standard Rate for the LVDF Customer Class	41
	a.	Positions of the Parties; the ALJ	41

	b.	Commission Action	42
3.		Minimum and Maximum Allowable Market (Flexible) Rates for the LVDF Customer Class	42
	a.	Positions of the Parties; the ALJ	42
	b.	Commission Action	44
E.		Consolidation of Rates in the Minnegasco-Minnesota and Midwest Gas-Northern Natural Rate Areas	45
	1.	Minnegasco's Proposal	45
	2.	Positions of the Parties; the ALJ	45
	a.	The Department	45
	b.	ALJ	45
	3.	Commission Action	45
F.		Residential Customer (Renamed Basic) Charges	46
	1.	Position of the Parties	46
	2.	Commission Action	46
	a.	Customer Acceptance	47
	b.	Effect on Conservation	47
	c.	Future Policy Left for Future Decision	48
G.		Other Customer (Renamed Basic) Charges	48
H.		Demand/Commodity (Three-Part Rate) Billing Option for C&I Customers	48
I.		Collection of Customer Load Information	48
J.		Compliance with Market (Flexible) Rate Tariffs	49
K.		Gas Purchasing Incentive Mechanism	49
	1.	Introduction	49
	a.	The Filings	49
	b.	The GPI Proposal	50
	2.	Comments of the Parties; the ALJ	50
	a.	Minnegasco	50
	b.	The Department	50
	c.	RUD-OAG	51

	d.	Suburban Rate Authority	51
	e.	The ALJ	51
3.		Commission Action	51
	a.	Background	51
	b.	The Minnegasco GPI Proposal	52
XX.		OVERALL FINANCIAL SUMMARIES	52
	A.	Rate Base Summary	52
	B.	Operating Income Statement Summary	53
	C.	Gross Revenue Deficiency	53
		ORDER	54

G-008/GR-93-1090 ORDER

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Don Storm
Tom Burton
Marshall Johnson
Cynthia A. Kitlinski
Dee Knaak

Chair
Commissioner
Commissioner
Commissioner
Commissioner

In the Matter of the Application of
Minnegasco, a Division of Arkla, Inc., for
Authority to Increase Its Rates for Natural Gas
Service in Minnesota

ISSUE DATE: October 24, 1994

DOCKET NO. G-008/GR-93-1090

FINDINGS OF FACT, CONCLUSIONS OF
LAW, AND ORDER

PROCEDURAL HISTORY

I. INITIAL PROCEEDINGS

On November 5, 1993, Minnegasco, a division of NorAm Energy Corp. (formerly known as Arkla, Inc.), filed a petition seeking a general rate increase of \$22.7 million, or 3.6%, effective January 4, 1994.

On December 16, 1993, the Commission issued an Order finding the Company's filing incomplete.

On January 26, 1994, the Commission issued Orders accepting the Company's filing (as of December 9, 1993, the date the Company completed its filing), suspending the proposed rates, and setting the matter for contested case proceedings. The Office of Administrative Hearings assigned Administrative Law Judge (ALJ) Richard C. Luis to the case.

In the January 26, 1994, NOTICE AND ORDER FOR HEARING the Commission directed the Company not to include the following matters in any proposed settlement: cost allocation between regulated and nonregulated services; recovery of the acquisition adjustment, and if relevant, from which customers; the Company's capital structure and the cost of capital; and incentive compensation.

On January 31, 1994, the Commission issued its ORDER ADOPTING INTERIM RATES, authorizing an interim rate increase of \$14.6 million, or approximately 2.3%, for service rendered on or after February 1, 1994.

The ALJ held a prehearing conference on February 1, 1994, and issued a Prehearing Order on March 1, 1994.

On March 2, 1994, the ALJ issued an Order Granting Motion for Leave to Make Errata Filings and Directing Further Filings. In that Order the ALJ established a separate schedule for filing testimony to incorporate the Commission's decision in a related docket (see Section V below). The Order also allowed the Company to file certain updated, corrected data.

II. PARTIES AND REPRESENTATIVES

A. Intervenor

The intervenors and their representatives in this matter are as follows:

The Department of Public Service (the Department), Scott Wilensky, Special Assistant Attorney General, 525 Park Street #500, St. Paul, Minnesota 55103; and Joshua Wirtschafter and Mark Chalfant, Special Assistant Attorneys General, 1200 NCL Tower, 445 Minnesota Street, St. Paul, MN 55101-2130.

The Residential Utilities Division of the Office of Attorney General (RUD-OAG), Gary R. Cunningham, Special Assistant Attorney General, 1200 NCL Tower, 445 Minnesota Street, St. Paul, MN 55101-2130.

The Minnesota Alliance for Fair Competition (MAC), James D. Larson, Wurst, Pearson, Larson, Underwood and Mertz, #1100, One Financial Plaza, 120 South 6th Street, Minneapolis, MN 55402.

Minnesota Energy Consumers (MEC), James J. Bertrand, Leonard, Street, & Deinard, 150 South Fifth Street, Suite 2300, Minneapolis, MN 55402.

Minnesota Suburban Rate Authority (SRA), James M. Strommen, Holmes and Graven, 470 Pillsbury Center, 200 South Sixth Street, Minneapolis, MN 55402.

The Regents of the University of Minnesota, Peter H. Grills, O'Neill, Burke, O'Neill, Leonard and O'Brien, 800 Norwest Center, 55 East Fifth Street, St. Paul, Minnesota 55101. This intervenor did not file briefs, appear at the hearings, or sponsor witnesses.

B. The Company

The Company was represented by Paul T. Ruxin, Jones, Day, Reavis & Pogue, North Point, 901 Lakeside Avenue, Cleveland, OH 44114; and Brenda A. Bjorklund and Douglas W. Peterson, Minnegasco Law Department, 201 South Seventh Street, Minneapolis, MN 55402.

III. PUBLIC HEARINGS AND PUBLIC TESTIMONY

The ALJ held public hearings to receive comments and questions from non-intervening ratepayers. Public hearings were held in Coon Rapids on April 21, 1994, in Minneapolis on April 25, 1994, in Bloomington on April 26, 1994, and in Mankato on April 28, 1994. There were two public witnesses at the Coon Rapids hearing, one each at the Minneapolis and Bloomington hearings, and three at the Mankato hearings. In total, there were approximately 90 people in attendance at the four public hearings.

In addition to the comments at hearing, the ALJ received approximately 75 written comments and phone calls regarding the proposed rate increase. Most of the comments were in opposition to the increase. Many of the people who submitted comments expressed concern with the increase to the residential customer charge.

IV. EVIDENTIARY HEARINGS

Evidentiary hearings were initially scheduled to begin May 5, 1994. Because the parties reached settlement on a number of the contested issues, the ALJ twice granted extensions of the hearing date. The final extension brought the hearing date to May 17, 1994. Hearings continued from that date through May 18, 19, 24, 25, and 26, and June 2, 3, 9 and 10, 1994.

Under Minn. Stat. § 216B.16, subd. 1a(a) (1993 Supp.), the ALJ's extensions to the procedural schedule to permit continuing settlement discussions extended the deadline for the Commission's final decision in this matter from October 10, 1994, to October 24, 1994.

V. OTHER RELATED DOCKETS

A. The MAC Complaint, Docket No. G-008/C-91-942

This docket developed in response to a complaint against Minnegasco submitted by MAC, a trade organization of plumbing, electrical and appliance associations. Among other things, the complaint alleged that Minnegasco subsidizes its nonregulated appliance sales and service operations through its regulated utility operations.

On November 10, 1992, the Commission issued its ORDER ESTABLISHING ACCOUNTING PROCEDURES AND REQUIRING FURTHER FILINGS. In that Order the Commission directed Minnegasco to adopt cost separation principles developed by the Federal Communications Commission (FCC). The Order also required the Company to submit filings regarding its winter residential gas leak detection program and various allocation issues.

On March 24, 1994, following a full contested case proceeding, the Commission issued its ORDER APPROVING COST ALLOCATION METHODS AND LEAK SURVEY PLAN WITH MODIFICATIONS, REQUIRING REPORT, FINDING VALUE IN GOOD WILL, AND DEFERRING VALUATION TO RATE CASE. In that Order the Commission reaffirmed that structural separation of the Company's regulated utility and nonregulated appliance operation was not necessary. The Commission found that Minnegasco's cost allocation system, embodied in its cost apportionment manual (CAM), was appropriate. The Commission found that there is value to Minnegasco's good will as used by its nonregulated appliance affiliate. The Commission defined good will as the Company's "name, image, and reputation." Order at p. 11. The Commission deferred further consideration of good will, including its valuation, to the Company's ongoing rate case.

On July 28, 1994, the Commission issued its ORDER GRANTING PARTICIPANT STATUS AND DENYING REQUESTS FOR RECONSIDERATION. In that Order the Commission reaffirmed its finding of value to Minnegasco's good will as used by its nonregulated appliance operation. The Commission continued to defer the actual disposition and valuation of the good will to the present rate case.

The Company and certain other energy utilities appealed the Commission's findings on good will. That appeal is currently before the Minnesota Court of Appeals.

B. Minnegasco/Midwest Exchange of Assets, Docket No. G-008, 010/PA-93-92

On July 29, 1993, the Commission issued its ORDER APPROVING EXCHANGE AND REQUIRING FILINGS. In that Order the Commission approved Minnegasco's acquisition of Midwest Gas Company's Minnesota property and deferred consideration of any acquisition adjustment until Minnegasco's next general rate case.

The Commission also required the Company to include the following filings in its next rate case:

1. Updated information, with explanation and supporting documentation, on the used and usefulness of the combined peak-shaving facilities, considering additional alternative capacity available or acquired through the exchange;
2. Full justification for its request to consolidate rates and PGAs and an explanation of the impact on current Minnegasco customers demonstrating that they would not be harmed as a result of the consolidation; and
3. Comments on the effect of the acquisition adjustment on the Minnegasco and former Midwest customers.

VI. THE SETTLEMENT AND STIPULATION

On June 10, 1994, Minnegasco, the Department and the RUD-OAG submitted to the ALJ an Offer of Partial Settlement and Stipulation of Facts. The document was actually comprised of two parts: a Settlement among the parties of many of the contested issues; and a Stipulation expressing the parties' agreement on various issues which the Commission had indicated should not be submitted as part of a settlement.

The other parties to the rate case did not support or object to the Settlement or Stipulation.

The ALJ directed the parties to split the document into its two components, the Settlement and the Stipulation.

On August 5, 1994, the ALJ submitted a letter to the Commission. The ALJ found that the Settlement is supported by substantial evidence in the record and that its acceptance by the Commission would be in the public interest. The ALJ recommended that the Commission accept the Settlement without modification.

The ALJ stated that he would consider the Stipulation separately in developing his final report and recommendations to the Commission on the remaining contested issues.

VII. PROCEEDINGS BEFORE THE COMMISSION

On August 26, 1994, the ALJ filed his final report and recommendations.

On September 21, 1994, the Commission heard oral arguments from the parties and on September 23, 1994, the Commission met to deliberate this matter.

Upon review of the entire record of this proceeding, the Commission makes the following Findings of Fact, Conclusions of Law, and Order.

FINDINGS AND CONCLUSIONS

VIII. JURISDICTION

The Commission has general jurisdiction over the Company under Minn. Stat. § 216B.01 and 216B.02 (1992). The Commission has specific jurisdiction over rate changes under Minn. Stat. § 216B.16 (1992).

The case was properly referred to the Office of Administrative Hearings under Minn. Stat. §§ 14.48-14.62 (1992) and Minn. Rules, part 1400.0200 et seq. (1993).

IX. FURTHER ADMINISTRATIVE REVIEW

Under Minn. Rules, part 7829.3000, any petition for rehearing, reconsideration, or other post-decision relief must be filed within 20 days of the date of the Order. Such petitions must be filed with the Executive Secretary of the Commission, must specifically set forth the grounds relied upon and errors claimed, and must be served on all the parties. The filing should include an original, 15 copies, and proof of service on all parties.

Adverse parties have ten days from the date of service of the petition to file answers. Answers must be filed with the Executive Secretary of the Commission and must include an original, 15 copies, and proof of service on all parties. Replies are not permitted.

The Commission, in its discretion, may grant oral argument on the petition or decide the petition without oral argument.

Under Minn. Stat. § 216B.27, subd. 3 (1992), no Order of the Commission shall become effective while a petition for rehearing is pending or until either of the following: ten days after the petition for rehearing is denied or ten days after the Commission has announced its final determination on rehearing, unless the Commission otherwise orders.

Any petition for rehearing not granted within 20 days of filing is deemed denied. Minn. Stat. § 216B.27, subd. 4 (1992).

X. THE COMPANY

On November 29, 1990, Minnegasco became an operating division of Arkla, Inc. Prior to that time, Minnegasco had been a wholly-owned subsidiary of Diversified Energies, Inc. In 1994, Arkla, Inc. changed its name to NorAm Energy Corp.

Minnegasco is a local distribution company (LDC) serving approximately 600,000 customers in Minnesota. The largest urban area served by Minnegasco is Minneapolis and its western suburbs. Minnegasco maintains its principal office in Minneapolis and has other offices throughout its service territory.

In a transaction approved by the Commission on July 29, 1993, and closed on August 31, 1993, Minnegasco acquired the Minnesota properties of Midwest Gas in exchange for Minnegasco's South Dakota properties and \$38 million cash. Largely as a result of the exchange, Minnegasco's Minnesota customers increased by approximately 100,000 since Minnegasco's 1992-93 rate case.

Minnegasco purchases gas from producers and also from interstate pipelines. Most Minnegasco customers are served with natural gas transported by Northern Natural Gas Company. Customers in the former Midwest Gas communities of Dalbo, Foreston, Milaca and Pease are served with gas transported by Viking Gas Transmission Company.

XI. BURDEN OF PROOF

Minn. Stat. § 216B.16, subd. 4 (1992) states: "The burden of proof to show that the rate change is just and reasonable shall be upon the public utility seeking the change." Under Minn. Stat. § 216B.03 (1992), every rate made, demanded or received by any public utility "...shall be just and reasonable...Any doubt as to the reasonableness should be resolved in favor of the consumer."

The Minnesota Supreme Court has articulated standards for the burden of proof in rate cases. In the Matter of the Petition of Northern States Power Company for Authority to Change Its Schedule of Rates for Electric Service in Minnesota, 416 N.W. 2d 719 (Minn. 1987). In the Northern States Power case the Court divided the ratemaking function of the Commission into quasi-judicial and legislative aspects. The Commission acts in a quasi-judicial mode when it determines the validity of facts presented. Just as in a civil case, the burden of proof is on the utility to prove the facts by a fair preponderance of the evidence. Such items as claimed costs or other financial data are facts which the utility must prove by a fair preponderance of the evidence.

The Commission acts in a legislative mode when it weighs the facts presented and determines if proposed rates are just and reasonable. Acting legislatively, the Commission draws inferences and conclusions from proven facts to determine if the conclusion sought by the utility is justified. The Commission weighs the facts in light of its statutory responsibility to enforce the state's public policy that retail consumers of utility services shall be furnished such service at reasonable rates. In its legislative capacity, the Commission forms determinations such as the usefulness of a claimed item, the prudence of company decisions, and the overall reasonableness of proposed rates.

The utility therefore faces a two part burden of proof in a rate case. When presenting its case in the rate case proceeding, the utility has the burden to prove its facts by a fair preponderance of the evidence. The utility also has the burden to prove, by means of a process in which the Commission uses its judgment to draw inferences and conclusions from proven facts, that the proposed rates are just and reasonable.

XII. TEST YEAR

The Company proposed a projected 1994 test year ending December 31, 1994. The Company developed test year data by making adjustments to calendar year 1992 actual data. The test year consolidates Midwest and Minnegasco operations. Total test year revenues are \$631 million.

The Commission agrees with the ALJ that the Company's proposed 1994 test year is appropriate. The Commission accepts the Company's proposed test year for purposes of this general rate case.

XIII. THE SETTLEMENT AND THE STIPULATION

In the Order setting this case for hearing, the Commission asked the parties not to settle four issues the Commission believed required full evidentiary development. Those issues were cost allocations between regulated and unregulated operations, capital structure and cost of capital, ratemaking treatment of an acquisition adjustment resulting from a 1993 property exchange with Midwest Gas, and incentive compensation for Company employees.

Settlement discussions between the parties resulted in the Company, the Department, and the RUD-OAG reaching agreement on most of the financial and rate design issues in the case, including the four issues listed above. In deference to the Commission, they did not settle the four issues but placed them instead in a Stipulation of Facts and Recommended Decision (stipulation), which included other issues as well. The settled issues they placed in a separate document, the Offer of Partial Settlement (the settlement).¹

The stipulation and settlement have different purposes and functions and must be treated differently. The stipulation documents agreement by the parties on discrete factual and policy issues which have been resolved independently of one another. It is not presented as the product of compromise. Its resolution of any individual issue does not depend upon its resolution of any other issue or upon accepting the stipulation as a package.

The effect of the stipulation is the same as the effect of the parties individually taking the same position on the stipulated issues. The parties have simply formalized their agreement on the stipulated issues and offered their consensus as evidence of the reasonableness of their positions. For these reasons, the Commission may accept parts of the stipulation without accepting others, and without giving the parties a chance to change their positions on the stipulated issues.

The settlement, on the other hand, is offered as the product of compromise. Settlements are encouraged under Minn. Stat. § 216B.16, subd. 1a (Supp. 1993), which requires the Commission to consider and deal with them as a package. The statute recognizes that a settlement is an integrated whole whose individual provisions are mutually dependent and may be linked in ways that are not immediately apparent. Therefore, the statute gives any settling party the right to reject any modification the Commission makes to a settlement and to return to hearing.

The stipulation and settlement taken together would reduce the Company's revenue deficiency from \$22,722,000 to \$10,972,000, based on an overall rate of return of 9.67%. The requested rate increase would fall from 3.6% to 1.74%.

The Administrative Law Judge examined the settlement, and each issue settled, for reasonableness and support in the record. He found that the settlement was supported by substantial evidence and that accepting it would be in the public interest. He recommended accepting it without modification.

He also examined each issue in the stipulation and found the stipulation's resolution of each issue reasonable and supported by substantial evidence in the record. He recommended accepting the stipulation on every issue.

The Commission will consider the settlement and the stipulation separately.

XIV. SETTLEMENT MODIFIED AND ACCEPTED

¹ The parties who did not sign these documents did not take issue with them, with two exceptions. MAC contested the allocation of gas leak calls assumed in the stipulation, and the SRA challenged proposed customer charges which the stipulation characterized as "non-disputed." Both issues are discussed in sections of this Order dealing with disputed issues.

A. Structure and Content of the Settlement

The settlement, which is attached, resolves the following issues:

Financial Issues

- (a) Compliance issues arising from two Orders on accounting matters issued after the rate case was filed;
- (b) Errata adjustments to the Company's original filing;
- (c) Manufactured gas plant clean-up costs;
- (d) Natural gas vehicle expenses;
- (e) Advertising expenses;
- (f) Marketing expenses;
- (g) General inflation adjustment;
- (h) Expense allocations between the Company and its parent; (i) Expenses attributable to now-divested Nebraska and South Dakota operations;
- (j) Carbon monoxide testing expenses;
- (k) Rate case expenses;
- (l) Lobbying expenses;
- (m) Employee membership dues expenses;
- (n) In-kind charitable contribution expenses;
- (o) Financial effects of a liquified natural gas contract with Burlington Northern Railroad;
- (p) Miscellaneous expenses falling generally within the categories of lobbying, meals, flowers, and tickets;
- (q) Economic development expenses;
- (r) Depreciation adjustment;
- (s) Allocations impact of carbon monoxide testing;
- (t) Allocations impact of correcting error in test year figures on average minutes per job on customer service calls.

Rate Design Issues

- (a) Midwest-Northern area demand costs;
- (b) Large General Service demand/commodity billing;
- (c) Market-rate tariff clarification;
- (d) PGA and general billing format and organization;
- (e) Exploration of seasonal rate potential;
- (f) Firm transportation rates;
- (g) Weather normalization adjustment.

The parties included in their Offer of Settlement thorough support from the record for their resolution of every issue. They also made their witnesses available for questioning by the Administrative Law Judge and Commission staff, to clarify the evidentiary basis for settled positions if necessary.

Since the Commission must base its rate case decisions on the record, these steps substantially increase the settlement's value and credibility. Minn. Stat. § 14.60, subd. 2 (1990). While the Commission does conduct an independent review of the record before acting on any settlement, it is reassuring and helpful for the parties to demonstrate, as they have here, that the content of the record was central to their negotiations on every issue.

B. Commission Action

The Commission finds that the settlement, with one exception, is supported by substantial evidence, represents a just and reasonable resolution of the individual issues settled, promotes the public interest, and will result in just and reasonable rates. The Commission will modify the settlement on the issue of manufactured gas plant clean-up costs. As to all other issues, the

Commission accepts and adopts the settlement.

Minnegasco originally sought to include in test year expenses \$4,615,000 to clean up former manufactured gas plant sites in compliance with state and federal environmental protection statutes. The Company also proposed to establish a tracker account to record actual clean-up costs and to adjust rates annually to reflect actual costs.

The settlement granted annual rate recovery of \$4,210,000, of which \$420,000 was attributable to amortization of costs incurred in 1992 and deferred. The remainder of the \$4.2 million was attributable to projected annual clean-up costs.

Under the terms of the settlement agreement, the Company withdrew its tracker account/rate adjustment proposal. It also agreed to place any insurance recoveries in a deferred debit account without carrying charges for consideration in the next rate case.

The tracker account/rate adjustment proposal in the original filing was a clear acknowledgment of the fact that manufactured gas plant clean-up costs are notoriously difficult to predict. These costs involve complex liability and insurance issues which often require litigation, changing cost estimates and disrupting projected time frames. The extent of environmental damage is seldom clear at the outset and often does not become clear until clean-up is well underway, further complicating attempts to forecast costs and time frames.

Clean-up is a multi-stage process; each stage has its own time frame and its own costs. Delays in completing one stage, or new information discovered during one stage, directly affect the cost and timing of subsequent stages. Finally, the Company and other potentially liable parties have considerable discretion over when to begin and how vigorously to pursue each stage of clean-up.

For all these reasons, the amount and timing of clean-up costs is hard to forecast with any accuracy. In its last rate case² the Company sought \$5,060,000 in test year clean-up costs; its actual test year costs proved to be \$658,000. This \$4.4 million discrepancy illustrates the difficulty of estimating manufactured gas clean-up costs and suggests at least an historical weakness in this area on the part of the Company. Given these facts, the Commission cannot approve the inclusion of the settlement amount in rates.

Instead, the Commission will modify the settlement to limit annual clean-up cost recovery to 50% of the settlement amount, \$2.105 million. That figure is a pragmatic compromise between the settlement amount and the amount that would result from applying the ratio between projected and actual costs from the test year in the last rate case. The first figure is too high, given the elusive nature of these costs and the Company's track record in estimating them. The second figure is too low, given the Commission's assumption that the Company has analyzed the reasons for the \$4.4 million discrepancy and benefitted from that analysis in formulating this request.

To protect the Company and to avoid inadvertently discouraging environmental clean-up, the Commission will grant deferred accounting treatment to actual costs in excess of amounts authorized here. The goal is to ensure full recovery of environmental clean-up costs while avoiding over-recovery.

Finally, to protect ratepayers, the Commission will direct the Company to record in a deferred credit account without carrying charges all insurance or other third party recoveries for clean-up costs. Ratemaking treatment of those amounts will be addressed in the next rate case.

XV. STIPULATED ISSUES RESOLVED

A. The Stipulated Issues

The parties resolved the following issues on a stand alone basis by stipulation:

- (a) Cost allocations impact of certain work performed as part of commercial and industrial jobs;
- (b) Financial impact of cost allocations decisions in related docket G-008/C-91-942;
- (c) Ratemaking treatment of acquisition adjustment resulting from 1993 property exchange with Midwest Gas;
- (d) Cost allocations for carbon monoxide checks;
- (e) Cost of capital and rate of return;
- (f) Ratemaking treatment of peak shaving facilities acquired from Midwest Gas;
- (g) PGA treatment of demand costs treated in related dockets G-008/M-93-866 and G-008/M-93-868

² In the Matter of the Petition of Minnegasco, a Division of Arkla, Inc. for Authority to Increase Rates for Natural Gas Service in Minnesota, Docket No. G-008/GR-92-400.

- (h) Ratemaking treatment of incentive compensation for Company employees;
- (i) Funding mechanism for FAS 106 expenses;

As they did with the Offer of Settlement, the parties included in the stipulation citations to evidence in the record supporting their resolution of every issue. They also made their witnesses available for questioning by the Administrative Law Judge and Commission staff, to clarify the evidentiary basis for stipulated positions if necessary. This was as helpful to the Commission in analyzing the stipulated issues as it was in analyzing the settlement.

The Administrative Law Judge found the stipulated resolution of all issues reasonable, supported by substantial evidence, and consistent with just and reasonable rates. He recommended accepting the stipulation's resolution of every issue.

B. Summary of Commission Action

The Commission has examined every issue the parties resolved by stipulation. The Commission concurs in, accepts, and adopts the findings, recommendations, and rationale of the Administrative Law Judge on all issues except incentive compensation and the appropriate funding vehicle for FAS 106 obligations.

Although the Commission accepts and adopts the stipulated resolution of capital structure and cost of capital issues, the financial strength and stability of Minnegasco's parent company are matters of grave and continuing concern. The Commission will therefore require filings addressing these issues within the next 60 days.

C. Incentive Compensation Tracker Established

The Commission has a longstanding interest in the role of incentive compensation in utility wage structures. The Commission has found that incentive compensation plans can be effective management tools when properly designed and administered. At the same time, the Commission has expressed concern about their potential, if poorly designed or administered, to work to the detriment of ratepayers.³

Poorly designed incentive compensation plans can promote short-term thinking, exacerbate conflicts of interest between shareholders and ratepayers, and inappropriately shift financial risk from shareholders to ratepayers. For these reasons the Commission asked the parties not to settle any disputes they might have about Minnegasco's incentive compensation plan.

They did not settle, but they found themselves in agreement. They stipulated that the Company's overall compensation costs are slightly below the market average. They also stipulated that total compensation amounts, including the incentive component, are just and reasonable and should be included in rates. The Commission agrees, with two qualifications.

First, while total compensation amounts are important in evaluating the reasonableness of any incentive compensation plan, even a plan yielding below-market wages can be so ill-conceived or badly administered that it jeopardizes ratepayer interests. It can, for example, link such a high percentage of salary to short-term corporate financial gains that it compromises quality of service. For these reasons, the Company's low overall salary levels should not permanently shield its incentive compensation program from review.

To ensure comprehensive review of the Company's incentive compensation program in the future, the Commission will require the Company to include in its next rate case filing a detailed description of its incentive compensation program. This will permit the comprehensive review

³ In the Matter of Petition of Northern States Power Company's Gas Utility for Authority to Change Its Schedule of Gas Rates for Retail Customers Within the State of Minnesota, Docket No. G-002/GR-92-1186, FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER (September 1, 1993) and ORDER AFTER RECONSIDERATION (December 30, 1993).

necessary to ensure that the plan does not contain disincentives to regulatory compliance, long term planning, and similar values unique to companies providing essential services in a monopoly environment. The Commission will again ask the parties not to settle any disputes regarding the Company's incentive compensation plan.

The second qualification stems from the Company's apparent retention of the right not to make incentive payments earned under the plan. As the Commission explained in the NSP case cited above, this is a serious defect:

Another of the plan's serious defects is that the Company retains the right not to make incentive payments earned under the plan. Management exercised this prerogative in 1992 and did not disclaim its ability to do so in the future. This is a clear case of transferring risk from shareholders to ratepayers. If expenses are unexpectedly high or revenues unexpectedly low, shareholders can offset these losses with funds provided by ratepayers for the incentive compensation program. This runs contrary to the test year concept on which rates are based, and the Commission strongly disapproves.

In the Matter of Petition of Northern States Power Company's Gas Utility for Authority to Change Its Schedule of Gas Rates for Retail Customers Within the State of Minnesota, Docket No. G-002/GR-92-1186, FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER (September 1, 1993).

The Commission continues to believe that management retention of the right to withhold incentive compensation earned under the plan is serious enough to warrant corrective action. In this case, as in the NSP case, the Commission will require the Company to record all earned but unpaid incentive compensation recoverable in rates under this Order for future return to the ratepayers. This will adequately protect ratepayers' interests and prevent erosion of the test year concept.

D. External Funding of FAS 106 Obligations Required

1. Factual Background

In December of 1990, the Financial Accounting Standards Board (FASB), which establishes accounting standards for U.S. businesses, issued Financial Accounting Standard 106 (FAS 106). In accordance with that standard, expenses for certain postretirement benefits (PBs), primarily health and life insurance, would be recognized on a pro-rata basis during an employee's period of employment. This type of accounting differed from the so-called pay-as-you-go basis of accounting that was acceptable prior to the issuance of FAS 106.

Under FAS 106, proper accounting for PBs also included the measurement and recognition of a transition obligation, which is the unfunded and unrecognized accumulated postretirement benefit obligation at the time the utility moves from pay-as-you-go to accrual accounting. In Minnegasco's previous rate case, Docket No. G-008/GR-92-400, the Commission approved recovery of the transition obligation and included in rates the amortization of the transition obligation plus associated interest.

Adopting FAS 106 results in the Company's collecting revenues that it does not currently have to pay out for postretirement benefits.

The liability for future postretirement benefits would be paid from corporate cash funds if the obligation is funded internally or from a trust fund if the obligation is funded externally. A third option is a combination of internal and external funding of the PB liability. Because the future obligation represents a significant cost to the Company, the Commission is concerned that sufficient funds be available to pay the benefits at the proper time. The Commission concluded in its July 19, 1993 ORDER AFTER RECONSIDERATION in Minnegasco's last rate case that protection of ratepayers, shareholders, and employees may require external funding of

postretirement benefit obligations in the future. Minnegasco was required to explore its options to establish a tax advantaged external funding. Minnegasco addressed these options in its rate case testimony.

2. Position of the Parties; the Stipulation

a. Minnegasco

Minnegasco argued against external funding of its postretirement medical expenses because the external funding vehicles are more costly than internal funding. According to Minnegasco, in choosing among the various funding vehicles, the utility should consider not only the tax deductibility but also the security of benefits; the effect on total cost of providing the benefits; whether the plan assets can be considered "plan assets" under FAS 106; universal plan participant coverage; and exposure to penalties. None of the external funding vehicles fully satisfies these criteria for Minnegasco.

Two types of tax deductible funding vehicles that Minnegasco discussed are a 401(h) trust and a Voluntary Employees' Beneficiary Association (VEBA) 501(c)(9) trust. A 401(h) trust has a tax deductible limit of 25% of a Company's contribution to a pension plan. Minnegasco's pension is fully funded and therefore it would not be able to make a tax deductible contribution to a 401(h) plan. Although contributions to a collectively bargained VEBA 501(c)(9) trust would be eligible for tax deduction, Minnegasco has not bargained a trust with its unions so the VEBA trust is not an option for external funding. Minnegasco argued that it should continue to fund internally because tax deductible alternatives are not available to Minnegasco.

According to Minnegasco, internal funding is less costly to ratepayers. If the liability is internally funded Minnegasco will reduce its rate base for the after-tax amount of the unfunded liability and thereby reduce its revenue requirement.

b. The Department

The Department agreed with Minnegasco that it should not be required to externally fund its postretirement medical liability. According to the Department, external funding should only be used if there are associated tax benefits. In Minnegasco's and NSP's most recent rate cases, the Commission required the use of the least costly funding mechanism. Although the Commission ordered NSP to have an external funding mechanism in place by the time it files its next general rate case, external funding would be limited to the extent that there are tax benefits to offset any additional cost. Since Minnegasco does not have a collectively bargained VEBA available to it, or some other tax advantaged external funding vehicle, the Department recommended that Minnegasco not be required to externally fund its FAS 106 costs.

c. The Stipulation

The parties stipulated that external funding of FAS 106 costs is not practical for Minnegasco at this time because of the tax deductibility limitations.

3. Commission Action

In previous rate case proceedings, the Commission has expressed a preference for external funding of PB obligations. In the 1993 NSP rate case, the Commission noted the need to strengthen ratepayer security, the fact that accrued PB funds are often used in the distant future, and the significant amount of the utility's obligation. The Commission required NSP to have VEBA funding in place by the time of the utility's next general rate case.

In the Minnegasco case, a further concern is the parent company's highly leveraged financial condition.

The Commission recognizes that external funding poses some disadvantages for Minnegasco at this time. The Company's pension is fully funded and it is therefore unable to make a tax deductible contribution to a 401 (h) plan. Minnegasco has not bargained a trust with its unions and there are therefore no tax advantages to a VEBA trust at this time. External funding of PB liability may not be cost-beneficial under the present circumstances.

Because the Commission continues to believe that external funding is preferable to internal, the Commission will require Minnegasco to establish an external funding vehicle and to have it in place within 18 months of the date of this Order, or by the time the Company files its next rate case, whichever comes sooner. The funding mechanism must be used as soon as tax advantages can be utilized. This time frame will ensure that the Company is moving toward greater security for its ratepayers, while allowing the Company sufficient time to develop and implement the most advantageous external funding plan.

When examining alternatives for external funding, the Company should most carefully consider the VEBA trust vehicle. This option has an established track record and has proven effective and secure in other cases. Because the Commission believes that the VEBA trust would

effectively increase ratepayer and employee security in this case, the Commission will require the Company to adopt this funding method unless it demonstrates to the Commission's satisfaction that the VEBA trust would be impractical or otherwise inappropriate.

XVI. FUTURE FILINGS REQUIRED

Minnegasco is a division of NorAm Energy Corporation, formerly Arkla, Inc., and has no capital structure of its own. The Company continues to carry a hypothetical capital structure on its books, however. That capital structure consists of its common stock, additional paid-in capital, and retained earnings on the date it was purchased, adjusted for income earned and dividends paid to the parent since that date. On the date of filing that hypothetical capital structure was 50.2% long term debt and 49.8% common equity. The Company originally proposed to base rates on that capital structure.

The parties stipulated to a hypothetical capital structure of 49% long term debt, 2.4% short term debt, and 48.6% common equity. The Administrative Law Judge found the stipulated capital structure supported by substantial evidence, reasonable, and consistent with setting just and reasonable rates. He recommended accepting and adopting it. He made similar findings and recommendations on the stipulated return on common equity (11%) and overall rate of return (9.67%). The Commission accepts and adopts his findings, conclusions, recommendations, and reasoning.

The Commission agrees that at this point it is in the public interest to base Minnegasco's rates on the stipulated hypothetical capital structure instead of the only actual capital structure available, NorAm's.

Minnegasco, a local distribution company, and NorAm, a diversified energy company engaged in the interstate transmission and local distribution of gas, are fundamentally different enterprises despite their affiliation. They have different business risks and would be perceived differently by investors on a stand alone basis. If they were independent entities, their capital structures would differ from each other.

NorAm's actual and Minnegasco's hypothetical capital structures do reflect these differences. NorAm is highly leveraged, with equity constituting only 24.58% of its capital structure. Minnegasco's hypothetical capital structure represents a 49.8% level of common equity. This hypothetical capital structure is consistent with industry norms for local distribution companies and more accurately reflects a capital structure that would be expected from Minnegasco on a stand-alone basis. These are powerful justifications for using a hypothetical capital structure for ratemaking purposes. They have convinced the Commission to use a hypothetical capital structure in this case.

At the same time, however, the Commission cannot ignore two troubling facts. The first is that basing rates on a hypothetical capital structure results to some extent in ratepayers paying hypothetical costs, a problem under cost-of-service ratemaking. The second is that NorAm's capital structure and overall financial condition may be weak enough to place Minnegasco's quality of service in jeopardy. These concerns will be addressed in turn.

A. Hypothetical Versus Actual Capital Structure

Under Minnesota law this Commission sets rates to allow utility shareholders an opportunity to recover the costs of providing service and to earn a fair and reasonable return on their investment. Minn. Stat. § 216B.16, subd. 6 (1992). Basing rates on a capital structure radically different from the one financed by shareholders complicates the process of determining the costs of doing business and providing service.

For example, the tax consequences of Minnegasco's hypothetical capital structure may be very different (and less favorable) than the tax consequences of NorAm's actual capital structure.

Minnegasco's rates therefore include a higher tax component than NorAm's actual capital structure would support. Of course, other consequences of using the hypothetical capital structure may be more favorable to ratepayers than the consequences of using NorAm's actual capital structure.

There are no easy answers to the questions raised by Minnegasco's lack of an independent capital structure. However, those questions were not seriously explored in this case. They should be fully developed in the next rate case, especially in terms of their tax consequences, which may have serious financial impact on ratepayers.

The Commission will therefore require the Company to include in its next rate case filing detailed explanations of and comparisons between the tax consequences of basing rates on NorAm's capital structure and the tax consequences of basing rates on Minnegasco's proposed capital structure. The Commission asks parties to the next case to develop these issues fully.

B. NorAm's Financial Condition Vis-a-Vis Minnegasco

Another issue of grave concern to the Commission is the highly leveraged financial condition of NorAm, the parent company, and how this might affect Minnegasco. This issue was not fully developed by the parties, who assured the Commission that in the long run Minnegasco and its customers would thrive even if financial disaster struck NorAm.

The Commission basically concurs in this long run view, but also feels a deep obligation to protect customers in the short run. In the winter, customers need heat every day. They need a safe distribution system year around. Any threat to safe, reliable service, however short-lived, is unacceptable. A full scale financial crisis at NorAm could briefly jeopardize Minnegasco's ability to respond to safety calls and to ensure uninterrupted gas supply. The Commission is obligated to do everything within its power to keep this from happening.

Furthermore, the Commission is not as convinced as the parties appear to be that NorAm's financial condition will never affect Minnegasco's long term performance and prospects. It is clearly conceivable that a long uphill struggle against insolvency could deprive Minnegasco of the resources necessary to remain a sound, let alone thriving, local distribution company. A parent company in serious financial trouble might not make the investments necessary to maintain a solid infrastructure, reliable long term gas supplies, and a quality work force. Without these things, Minnegasco's long term ability to provide high quality service would be at risk.

The Commission finds it necessary to assure itself that Minnegasco has access to the resources necessary to provide the quality of service the public interest demands. The Commission will therefore require the Company to file the following information within 60 days:

- (a) Minnegasco balance sheets for calendar years 1991, 1992, and 1993, prepared in accordance with generally accepted accounting principles;
- (b) cash flow statements, prepared in accordance with generally accepted accounting principles, for Minnegasco for calendar years 1991, 1992, and 1993, providing sufficient detail in every category to identify cash transactions between Minnegasco and NorAm;
- (c) an explanation of NorAm's strategy for improving its capital structure, including the strategy's effect on dividend policy, and including NorAm's target equity ratios for the next three years.

With this information in hand, the Commission will determine whether further action is necessary.

XVII.REMAINING CONTESTED FINANCIAL ISSUES

A. Good Will

1. Introduction

The issue of good will flowing from Minnegasco's regulated utility operation first arose in a prior docket, No. G-008/C-91-942 (the MAC/Minnegasco docket). In that complaint proceeding, MAC alleged that Minnegasco subsidizes its nonregulated appliance sales and service operations through its regulated utility operations.

On March 24, 1994, following contested case proceedings, the Commission issued its ORDER APPROVING COST ALLOCATION METHODS AND LEAK SURVEY PLAN WITH MODIFICATIONS, REQUIRING REPORT, FINDING VALUE IN GOOD WILL, AND DEFERRING VALUATION TO RATE CASE in the MAC/Minnegasco docket. In that Order the Commission defined good will as the "utility's name, image, and reputation." Order at p. 10. The Commission found that it has the authority to determine a value for Minnegasco's good will as it is used by its nonregulated appliance affiliate. The actual quantification of the value was deferred to Minnegasco's ongoing rate case.

On July 28, 1994, the Commission issued its ORDER GRANTING PARTICIPANT STATUS AND DENYING REQUESTS FOR RECONSIDERATION. In that Order the Commission confirmed that it has authority to find value for good will and to impute revenue to the utility from the affiliate's use of the good will. The Commission found that its authority rests in its duty to set just and reasonable rates under Minn. Stat. §§ 216B.03 and 216B.08. The Commission cited the affiliated interest statute, Minn. Stat. § 216B.48, as further authority to impute revenues where necessary to protect and promote the public interest. The Commission found that its inherent ratemaking authority to impute utility revenue was recognized in In the Matter of the Application of Northwestern Bell Telephone Company, 367 N.W. 2d 655 (Minn. App. 1985) (the Bell case). The Commission also cited decisions in other state jurisdictions in which state commissions imputed revenues for uncompensated use of utility good will by an affiliate.

In its July 28, 1994, final Order in the MAC/Minnegasco docket, the Commission therefore determined that the Commission has authority to find value in a utility's good will and to impute revenue to the utility for the affiliate's use of good will.

2. Comments of the Parties; the ALJ

a. Minnegasco

Minnegasco cited the same points it had raised in the MAC/Minnegasco docket to argue that the Commission lacks legal authority to impute revenue for good will. Minnegasco argued that good will is an asset which belongs solely to shareholders; ratepayers do not possess an equitable interest in good will. Minnegasco also argued that imputing revenues for the affiliate's use of good will goes beyond cost-of-service ratemaking and is not authorized by the affiliated interest statute. Because imputation is beyond the Commission's statutory authority, Minnegasco argued, the result would be confiscatory.

Minnegasco stated that its rates do not reflect or support a value to good will. The Company noted that good will advertising is not allowed in rates, and that rates do not reflect an acquisition of the good will asset.

Minnegasco argued that the fully allocated cost methodology embodied in its CAM should prevent any cross-subsidy. This fact obviates the need for revenue imputation to correct any improper allocation.

Minnegasco's expert used industry data to calculate the financial performance of a proxy group of appliance sales and service entities. He compared this group's net income with those of the Minnegasco appliance operation. According to Minnegasco, its expert concluded that the

allocated costs arising from affiliation mean that good will possesses a negative net value for the nonregulated operation.

b. MAC

MAC offered 5% as the proper imputation of the nonregulated operation's revenues. MAC noted that the Commission had previously applied 5.24% in the Bell case. MAC argued that the Company had admitted that good will in the Midwest Gas acquisition was valued at between 3.65% and 11.07%. Finally, MAC noted that other state commissions have established a value for good will which was as high as 5% of revenues.

c. The RUD-OAG

The RUD-OAG stated that the legality of a good will adjustment was conclusively decided by the Commission in its final Order in the MAC/Minnegasco complaint docket. The Commission's authority to impute revenue for the affiliate's use of good will is therefore not at issue in this proceeding.

The RUD-OAG did not submit testimony regarding the value of good will.

d. The Department

The Department stated that the Company's legal arguments should be rejected. The authority of the Commission to impute revenue for good will was decided by the Commission in the MAC/Minnegasco complaint docket. The Department also noted that a revenue imputation decision the Commission cited in the MAC/Minnegasco docket, Rochester Telephone Corporation, 145 PUR 4th 419 (Rochester I), was upheld by the New York State Appellate Division. Rochester Telephone Corporation v. Public Service Commission of the State of New York. Opinion and Judgment dated June 30, 1994, Docket No. 69820 (Rochester II).

The Department stated that Minnegasco's witness had addressed valuation of the appliance sales and service business--a matter which is not at issue here.

The Department asserted that the appliance operation's poor financial performance in the last year was due more to rising costs than to the implementation of the CAM. The Department argued that the application of a proper cost allocation system should not be a cause for alarm or for separating the operations.

According to the Department, if good will exists, it will influence the level of business or sales that a company generates and thus will impact the company's gross sales revenues. The Department concluded that good will exists.

The Department looked at other state commissions' decisions regarding revenue imputations and the record here and decided that the proper value of good will would be one percent of the nonregulated operation's gross revenues.

Although the Department recommended a finding that good will has a value of one percent of gross sales revenues, the Department did not recommend an adjustment to Minnegasco's revenue deficiency. The Department reasoned that the nonregulated entity's use of Minnegasco's good will did not result in any dissipation of the good will value or in any cost to Minnegasco ratepayers.

e. The ALJ

The ALJ found that the Commission's authority to impute revenues is grounded in its duty to set just and reasonable rates, pursuant to Minn. Stat. §§ 216B.03, 216B.16, and 216B.48.

The ALJ rejected the Company's argument that revenue imputation in this case would be

confiscatory. The ALJ found that revenue imputation, when part of the setting of just and reasonable rates, should not defeat investment-backed expectations. Just and reasonable rates will allow utility investors the opportunity to earn a fair return on their investment. The ALJ also found that revenue imputation is not in this case confiscatory because it does not appropriate utility property, and because its economic impact on investor expectations is negligible.

The ALJ found that the Department's recommended good will value of one percent of gross revenues was appropriate and reasonable.

Given that the Commission has authority to impute revenue for good will, and that a one percent value can be attached to the good will, the ALJ found that the decision to impute or not to impute revenue was a policy choice for the Commission. The ALJ offered five main reasons that the Commission should not choose to impute revenue in this case.

3. Commission Action

a. Summary of Commission Action

In deciding if revenue should be imputed for the value of good will to the nonregulated entity, the Commission must decide three main issues. First, does the Commission have the authority to impute revenue to the utility for the affiliate's use of the utility's good will? Second, if the Commission has the authority to impute, should it choose to do so in this case? Third, if the Commission determines that imputation is necessary to achieve just and reasonable rates, what is the value of the good will?

The first issue, the Commission's authority, has been definitively addressed and answered in the MAC/Minnegasco complaint docket. In its final Order in that proceeding, the Commission determined that it has authority, based upon statute and case law, to impute revenues. The Commission's decision regarding authority has been fully explicated in the MAC/Minnegasco Orders and is supported by the ALJ in the current proceeding. For these reasons, the Commission will confine its discussion of authority to one legal argument raised by the Company which goes to the core of the authority issue.

Moving to the second main imputation issue, the Commission disagrees with the ALJ's recommendation that revenue not be imputed in this case for the appliance operation's use of good will. The Commission finds that imputation is necessary for the setting of just and reasonable rates.

Finally, the Commission adopts the reasoning of the Department and the ALJ that a one percent good will value is supported in the record and will result in just and reasonable rates.

b. The Commission's Authority to Find Value in Good Will and to Impute Revenue for an Affiliate's Use of Good Will

The Commission will here address one legal argument against imputation which was not strongly raised in previous MAC/Minnegasco proceedings. The Company argued that an imputation of revenue for the use of good will would exceed the Commission's statutory authority and the parameters of cost of service ratemaking and would therefore be confiscatory. The ALJ found that imputation would not be confiscatory because it would not defeat cost of service principles or utility investor expectations, and would not amount to the appropriation of utility property.

The Commission agrees with and adopts the ALJ's reasoning on this issue. Imputation of revenue for the use of good will is like other revenue adjustments the Commission makes in the course of setting rates. The imputation is not confiscatory when, as here, it is grounded in sound regulatory practice and the Commission's underlying authority to set just and reasonable rates.

In the July 28, 1994, MAC/Minnegasco Order, the Commission found that the value of good will

is supported by Minnegasco ratepayer contributions:

Ratepayers inarguably pay the costs of utility operations. Good will, though intangible, arises from and is intrinsic to the core business. Reliable provision of service, good management (i.e. paid employee) decisions, and the use of utility plant itself all result in a name, image, and reputation for the utility. Order at p. 13.

In the same Order, the Commission explained that the concept of good will value arises in the context of utility diversification.

The need for recognition of intangible good will can arise when the utility makes the choice to set up an affiliated entity which shares the utility name and engages in related but nonregulated business. When the utility moves out of the regulated, monopolistic environment into a competitive, nonregulated realm, value attaches to the good will of the core utility. Id.

If good will value flows from the utility to the affiliate which shares its name and reputation, a regulator setting a revenue requirement and ensuing rates must take this use of value into account. The regulator must ensure that the utility's rates reflect prudent use of the good will value.

In the Rochester I decision, the New York state commission explained the connection among ratepayers' support of the core business, diversification, and the commission's duty to scrutinize affiliated operations in order to set just and reasonable rates:

...while ratepayers had no right of ownership in a utility's assets, they nonetheless had an "equitable interest" in those assets. More specifically,... "while ratepayers may have no right of ownership in utility assets, they clearly have a legitimate interest in seeing that those assets are used to maximize benefits to them, and it can be inferred that the Commission has the authority to assure that ratepayers are compensated for the non-utility use of such assets, if no substantive barrier exists." Order at p. 424.

The regulator must, if necessary, impute revenue to the utility to reflect in rates the nonregulated operation's uncompensated use of the good will value.

The authority to make such imputations in the present context follows from what has been held to be the Commission's obligation to protect ratepayers from improper transactions between a utility and its affiliates. Because ratepayers have funded the salaries, training, advertising, and other activities that generate good will, they are entitled to rate recognition of revenues received by the utility in exchange for the use of that asset by an affiliate or otherwise. Where the asset is used and no revenues are received in exchange, an imputation may well be warranted. Rochester II at p. 431.

The Commission has thus concluded that the Commission's duty to set just and reasonable rates requires recognition of the benefit flowing from the ratepayer-supported utility to its nonregulated affiliate. A level of rates which is just and reasonable provides the utility shareholder with the opportunity to achieve a reasonable return upon the shareholder's investment, and is thus clearly not confiscatory.

c. In This Case, Should the Commission Impute Revenue to Minnegasco for the Nonregulated Appliance Operation's Use of Good Will?

i. The Commission disagrees with the five reasons offered by the ALJ for a finding that revenue should not be imputed.

I. The Commission disagrees with the ALJ's statement that the Commission should not impute revenue because good will is a shareholder asset and because it is an intangible asset, not

recognized in rate base, which exists only for the benefit of shareholders.

The Commission stated in its July 28, 1994, MAC/Minnegasco Order that the fact that good will is an intangible asset means that it may not appear on utility books or in rate base but does not mean that it is an improper subject for revenue imputation.

For the reasons detailed in the preceding subsection, the Commission has found that ratepayers supporting the utility enterprise have an equitable interest in good will value. This interest creates in the regulator the obligation to ensure that the utility's assets are not dissipated, that is, disbursed without appropriate compensation.

The ALJ's finding that good will is solely a shareholder asset which exists only for the benefit of shareholders seems at odds with the ALJ's finding that imputation of revenue for good will is not confiscatory or beyond the Commission's authority. If ratepayers had no interest in good will, the Commission's rate adjustment for the value of good will would be beyond its scope and thus confiscatory. For the reasons it has stated, the Commission firmly believes that the revenue adjustment is not confiscatory but is necessary to the setting of just and reasonable rates.

II. The Commission disagrees with the ALJ that the Company's fully allocated cost methodology removes the need for imputation of revenue.

In the July 28, 1994, MAC/Minnegasco Order, the Commission specifically refuted this argument:

The Commission disagrees with Minnegasco's argument that revenue imputation for good will is not necessary because under FCC cost allocation methods the benefits of related operations are already shared. The FCC's concept of shared economies of scale and scope really refers to shared costs between the regulated and nonregulated entities. Shared economies of scale and scope would not encompass the concept of good will--a potential ongoing, franchise-like value arising from the affiliation between the regulated and nonregulated entities. FCC cost allocations do not cover the intangible benefit of good will to the nonregulated entity and would not preclude the imputation of revenue to compensate the regulated utility. Order at p. 14.

The Commission found in the MAC/Minnegasco Orders that imputation of revenue for good will is not confined to cost allocation methods but is part of a broad overall allocation of costs and revenues between the regulated utility and the nonregulated operation.

In its March 24, 1994, MAC/Minnegasco Order, the Commission also noted that no system for allocating costs between regulated and nonregulated entities is perfect. Imputation of revenues for good will is a further regulatory safeguard.

III. The Commission disagrees with the ALJ's conclusion that revenue should not be imputed because ratepayers do not suffer a detriment or experience the removal of a benefit.

The Commission has found that ratepayers experience a detriment if the utility makes the choice to diversify, then allows the value of good will to flow to the nonregulated affiliate without the compensation which would normally be expected. As the Commission stated in the July 28, 1994, MAC/Minnegasco Order, "imputation of revenue can be thought of as a means of protecting ratepayers from a utility's decisions resulting in lost revenue opportunities." Order at p. 14. In the same Order, the Commission stated that in these circumstances, imputation of revenue is authorized by the Commission's duty to protect ratepayers and to set rates which are just, reasonable, and in the public interest." Id.

IV. The Commission does not adopt the ALJ's reasoning that imputation is not necessary because there has been no dissipation of an asset.

The ALJ agreed with the Department's analysis of the Rochester decisions. According to the

Department, the New York commission and Appellate Court based their decisions on findings that good will value was dissipated by the utility's actions. Because there was no dissipation of good will value in the Minnegasco case, the Department reasoned, the Rochester cases do not support the need for imputation of revenue.

The Commission disagrees with the Department's and ALJ's analysis of the Rochester decisions. These decisions clearly refer to protecting ratepayers from utility's decisions which result in lost revenue opportunities. As the Appellate Court explained in Rochester II:

A utility in an arms-length transaction could be expected to receive revenues for allowing the use of its employees or goodwill, and our statutory obligation to set just and reasonable rates permits us to impute such revenues...where they are not in fact received. Order at p. 432.

Further, the Commission has merely cited the Rochester decisions as well-reasoned opinions which are persuasive but not controlling. The Commission has formed its own conclusion that a revenue adjustment is necessary to achieve just and reasonable rates in a situation in which the value of a utility's good will has benefitted the utility's affiliate without proper compensation. In such a situation, the value of good will is not diminished, but ratepayers lose the benefit of good will and are harmed when it is used without compensation.

V. Finally, the Commission disagrees with the ALJ's statement that revenue imputation is improper in this case because expenses that contributed to the development of good will are not recognized. The ALJ particularly cited the fact that ratepayers do not contribute to institutional advertising.

The Commission stated in the July 28, 1994, MAC/Minnegasco Order:

Ratepayers inarguably pay the costs of utility operations. Good will, though intangible, arises from and is intrinsic to the core utility business. Reliable provision of service, good management (i.e. paid employee) decisions, and the use of utility plant itself all result in a name, image, and reputation for the utility. Good will is [thus] engendered by much more than utility institutional advertising.

The concept of imputing revenue from the nonregulated affiliate's use of good will is equitable, because ratepayers supporting the utility enterprise are, and will continue to be, part of the venture into nonregulated competition. In addition, should diversification prove financially unfavorable, ratepayers bear the risk of a consequent higher cost of capital for the regulated entity. Order at p. 13.

The Commission has concluded that the ratemaking principles underlying the need for imputation--the Commission's duty to set just and reasonable rates, the ratepayers' equitable interest in the good will value which has arisen with the utility's diversification, the need to protect ratepayers from utility's decisions resulting in lost revenue opportunities--go much deeper than simply using institutional advertising as a measure of the cost of good will.

ii. Conclusion

For the reasons it has stated, the Commission rejects the ALJ's recommendation against revenue imputation, and finds that just and reasonable rates require an imputation in this case.

d. The Value of Good Will to be Imputed

The Commission agrees with the ALJ that logic, common sense, and the record require a finding that there is positive value in Minnegasco's good will as used by the appliance operation. The Commission also agrees with the Department and the ALJ that a good will value of one percent

of gross revenues is reasonable and supported by substantial evidence.

i. There is positive value to Minnegasco's good will.

In the March 24, 1994, MAC/Minnegasco Order, the Commission found that both logic and the record point to a value in good will.

In the Minnegasco case, both logic and the record indicate that a value flows to the nonregulated entity from Minnegasco's conduct of its regulated utility business. Minnegasco's long history of service and its widespread service coverage have made it "the gas company" in the minds of the public.

The record in this case also supports a finding of value in Minnegasco's name and good will. The East Metro Brand Marketing Test shows that Minnegasco's name can draw three times the customer inquiries to a new nonregulated venture than can an unrelated name. It is clear that the Minnegasco name brings value to the nonregulated entity. Order at p. 14.

The ALJ rejected Minnegasco's contention that the value of good will is measured by netting the appliance operation's allocated costs against its gross revenues. Not only did the resulting negative value defy reason, but the method was not designed to produce an actual measurement of good will.

Minnegasco's argument misses the point--the Commission seeks to know the value of "good will" as defined, standing alone, and is not concerned herein with the fact that the businesses' use of the name "Minnegasco" brings with it other financial consequences (for example, cost allocations mandated in the MAC Complaint case that may diminish the overall value of the nonregulated appliance operations). ALJ report at p. 38.

The Commission agrees with the ALJ's conclusion that a finding of negative value defies common sense and logic. As the Department noted, the fallacy of the Company's approach is made evident by its own witness's testimony. The Company testified that it is considering separating the appliance operation from the utility. If such a separation took place, the separate appliance business could properly retain the Minnegasco name but no longer share costs due to integrated operations. Good will value would still exist and would be measured without netting allocated costs against gross revenues. The Company's method of measuring good will value is not valid.

Reason and the record support a finding that Minnegasco's good will as used by the appliance operation has positive value. The next question is the amount of that value.

ii. The value of good will is one percent of revenues.

MAC's arguments based on the Midwest acquisition adjustment or the Commission's previous finding in the Bell case bear little if any relationship to the value of Minnegasco's good will to the appliance operation. The Commission will not rely on the testimony of MAC, except for the information regarding imputations set in other jurisdictions.

The Department's analysis rested on the premise that good will value will result in increased sales or revenues for the company. The ALJ agreed, noting Judge Benjamin Cardozo's observation that good will captures the human tendency of a satisfied customer to return to the same source for the same goods or service. ALJ report at p. 37.

The Department looked at the range of imputations in other jurisdictions, the fact that there must be a positive value to good will in this case, and the evidence available. The Department found

that one percent of gross revenues is a conservative estimate of value, absent an exhaustive market study. The ALJ agreed with the Department's reasoning.

Having examined the record and the recommendations of the parties and the ALJ, the Commission finds that the Department's measurement of good will should be adopted. The Appellate Court in Rochester II found that the New York state commission was able to make similar findings in the absence of precise data:

In situations such as this, where some adjustment is clearly needed but its amount cannot be precisely set, the Commission has applied its discretion to come up with a reasonable, albeit imprecise, amount. Order at p. 442.

In its analysis, the Commission used record evidence and applied its discretion and technical expertise. First, for the reasons noted previously, the Commission found that good will is a positive value, that is, it is greater than zero. The Commission noted the range of imputations from 2% to 5% in other jurisdictions. The Commission made use of the Department's testimony, in which the Department recommended a valuation methodology which has proven useful in business and regulatory settings. The Commission concludes that one percent of the affiliate's gross revenues is a proper measure of good will value.

This level of good will value is appropriate in this case for a number of reasons. The good will value is sufficient to provide just and reasonable rates and to protect ratepayers from harm. The amount imputed will still allow shareholders their constitutionally protected right to a reasonable return on their investment. Finally, the level can be adjusted in a future rate case if further record evidence indicates a change is necessary.

B. Cost Allocations for Gas Leak Checks

1. Factual Background

Cost allocations between Minnegasco's regulated utility operation and its nonregulated appliance sales and service operation were addressed by the Commission in the MAC/Minnegasco complaint proceeding, Docket No. G-008/C-91-942. The Commission's determinations on cost apportionments in that case were incorporated in this rate case proceeding as required by the Commission. Those allocation decisions reduced Minnegasco's test year costs by \$1,380,000.

Minnegasco's calculated adjustments from the MAC/Minnegasco docket included an allocation for gas leak checks. In accordance with the Commission's March 24, 1994 Order in the MAC/Minnegasco docket, costs of responding to customer calls for gas leaks were to be allocated based on whether the leak was on Company equipment or customer equipment. For most customers, the gas meter is the demarcation point dividing utility and customer owned equipment. Allocating costs based on whether it is utility owned equipment appeared to be a reasonable and straightforward approach. Responding to a gas leak call, however, does not always result in finding a leak.

2. Positions of the Parties

MAC disagreed with Minnegasco on how costs for gas leak calls were to be apportioned if no leak is discovered. Minnegasco, the Department, and the ALJ believed that calls when no leak is found should be charged to the regulated operations. Only calls that result in a repair to customer equipment would be charged to the nonregulated operation. According to the Department, this approach would reflect concern for public safety and provide a reasonable basis for allocation.

MAC interpreted the Commission's MAC Order to require allocation based on leaks that were discovered. Rather than treating calls where no leaks are found as regulated, these should be split between regulated and nonregulated based on calls that do result in discovery of a leak. MAC calculated a reallocation of costs reducing test year expenses by \$158,000 based on its

interpretation of the Commission's March 24, 1994 MAC/Minnegasco Order.

3. Commission Action

The Commission finds that clarification of its March 24, 1994, MAC/Minnegasco Order is necessary because of the uncertainty about calls where no leak is found. Adopting MAC's recommendation will result in fair allocation treatment that is consistent with the intent of the Commission's MAC/Minnegasco Order. Costs of calls where leaks are discovered will be apportioned based on whether they are on customer owned equipment or on utility equipment. For situations where no leak is discovered, the same allocation shall be used as when a leak is discovered.

Minnegasco disagreed with MAC's calculation of its \$158,000 adjustment for gas leak checks. However, Minnegasco did not provide an alternative calculation or adjustment amount. Nor did Minnegasco explain the basis for its disagreement with MAC's adjustment. Therefore, the Commission adopts the adjustment recommended by MAC, reducing test year costs by \$158,000.

Minnegasco shall submit a compliance filing showing a detailed calculation of the adjustment for leak calls that conforms with the Commission's leak call allocation decision. The Company shall include, if practicable, the corrections to MAC's calculation and explain the specific items in MAC's calculation that Minnegasco believes are incorrect.

XVIII. OTHER FINANCIAL ISSUES

A. Management Audit

1. Department and ALJ Recommendation

The Department raised the concern that there seems to be an inordinate number of errors in Minnegasco's accounting records. The level and nature of errors are the result of the complexity of Minnegasco's accounting system, in particular its allocation system. To identify problem areas in the accounting system and possible solutions to prevent errors, the Department recommended an independent management audit of Minnegasco's accounting and financial departments. According to the Department, an audit could be done in conjunction with the work group established in the MAC/Minnegasco docket.

The ALJ agreed with the Department that the Commission should urge the Company to undertake a management audit. The work group established in the MAC docket could facilitate such an audit as it develops recommendations in its report.

2. Commission Analysis

The work group established in the MAC docket submitted its report of Findings and Recommendations on October 3, 1994. The work group did not discuss or recommend a management audit for Minnegasco.

The Commission agrees with the Department and ALJ that Minnegasco's financial recordkeeping and reporting need improvement. Errors in Minnegasco's financial information and the Department's difficulties in conducting its audit of Minnegasco's books should be addressed by Minnegasco. However, the Commission does not believe a management audit is necessary at this time, nor is it clear what specific issues a management audit would address. Minnegasco should work with the Department on these issues and hopefully resolve them informally. If the Department continues to experience difficulties with Minnegasco's financial recordkeeping and reporting, the Department can raise this concern again.

B. Test Year Financial Information

Utilities in Minnesota have had the discretion of using either a historical test year or a projected test year, in which projections are made from a base year.

Minnegasco's test year data in this case was filed based on 1992 actual data and projected to a 1994 test year period. Among the difficulties faced by Minnegasco in developing its test year data were the operational changes of divesting its Nebraska and South Dakota properties, the addition of Midwest properties, and implementation of a new comprehensive cost allocation system. These changes took place in 1993, resulting in a loss of comparability between the historical 1992 calendar year and the 1994 test year.

The Department raised the concern that Minnegasco's financial presentation of its case was difficult to investigate and contained errors due in part to the complexity of its accounting and cost allocation system. Similar concerns were raised when Minnegasco originally filed its rate case and acceptance was delayed because it was incomplete. Among the deficiencies noted in the Commission's ORDER FINDING FILING INCOMPLETE, dated December 16, 1993, was information on assumptions used in determining rate base and projecting elements of operating income.

It is important for the Commission's purpose of setting just and reasonable rates to gather substantive information on test year costs. Test year data must be verifiable and easily tested against a historical period for reasonableness. The Company clearly has the best understanding of how specific costs such as inflation are reflected in its test year costs. The burden therefore is on the Company to fully explain and demonstrate that its adjustments are correct and appropriate.

If a utility needs to update, recalculate or correct errors in its filing, the usefulness for the Commission's purpose of setting just and reasonable rates is diminished. If a utility cannot present useful, understandable financial information, one remedy would be to require it to use a historical test year. A historical test year may be easier for an intervenor to verify, analyze and make recommendations on than a projected test year.

Minnegasco projected both regulated and nonregulated costs to the 1994 test period. These costs included inflation. Errors identified by the Department included duplication of inflation adjustments and improper separation of regulated and nonregulated costs. To address the concerns raised about Minnegasco's test year data, the Commission finds it necessary to specify how inflation and jurisdictional costs are to be presented in the future.

If Minnegasco elects to use a projected test year in the future, it shall clearly show the components of inflation included in test year data. Furthermore, Minnegasco shall separate its historical regulated and nonregulated costs before projecting its jurisdictional test year costs. By separating the regulated from the nonregulated costs and then inflating only regulated costs, Minnegasco will be able to produce test year data which is more easily understood and which will aid in the determination of just and reasonable rates.

C. Conservation Cost Recovery

Minnegasco originally proposed to include \$6,217,500 for conservation improvement programs (CIP) in the test year. Minnegasco subsequently agreed with the Department that its test year costs should be lowered based on the approved CIP budget of \$1,188,687 in Docket No. G-008/CIP-92-151-Z. The Company's total approved CIP budget was \$6,111,721. Minnegasco proposed to include the CIP tracker balance in rate base and to amortize it over two years. The parties to the Settlement agreed to allow Minnegasco to recover its tracker balance by reducing the interim rate refund if the refund is sufficient to permit the tracker balance offset.

The Department proposed that the test year level of costs be based on the approved CIP budget and recommended that the tracker balance be recovered by reducing the interim rate refund. If the interim rate refund is insufficient to recover the total tracker balance then the remainder should be recovered in an amortization over three years.

The Commission finds the approved CIP budget to be a proper level for recovery as test year expenses. Because Minnegasco will be tracking its actual CIP costs and revenues, ratepayers pay and Minnegasco recovers the actual level of CIP costs. Actual costs and revenues are recorded in a tracker account. Any excess or shortfall in the tracker will be used to calculate a carrying charge based on Minnegasco's approved cost of capital.

A conservation cost recovery charge (CCRC) will be used to calculate the level of revenues credited to the tracker account. The CCRC is calculated by dividing test year CIP expenses by test year sales units. This rate per MCF will be used to credit revenues to the tracker based on actual MCF sales.

Minnegasco shall submit a compliance filing showing the calculation of the CCRC after final rates are approved by the Commission. A compliance filing will be necessary to determine how much recovery will be included in ongoing rates. Minnegasco shall also submit its calculation of recovery during the interim rate period. Minnegasco shall file its calculation of CCRC revenues collected during the interim rate period beginning February 1, 1994. This compliance filing shall be filed at the same time that Minnegasco submits its compliance filing for its interim refund calculation.

D. Refund Plan

Minnegasco was authorized to increase its rates effective February 1, 1994, on an interim basis, by \$14.6 million annually. The Company was ordered to maintain records of sales during the interim period for the purpose of refunding the difference between interim and final authorized rates. As part of the approved Settlement in this case, Minnegasco is permitted to offset the refund of interim revenues by: \$325,000, representing rate case expenses that have not been recovered from Minnegasco's and Midwest's 1992 rate cases; and the unrecovered CIP tracker balance as of the date final rates are ordered.

Minnegasco shall submit its refund plan incorporating the above adjustments in its calculations. Minnegasco's refund plan shall reflect the revenues collected during the interim period and interest calculated on the average prime rate for the affected customers.

XIX. REMAINING CONTESTED RATE DESIGN ISSUES

Minnegasco, the Department, RUD-OAG, and MEC submitted testimony and participated in oral argument relating to rate design. SRA participated in oral argument but did not submit written testimony.

A. Forecast

As part of its calculations for test year revenues and expenses, the Company projected customer numbers and gas sales volumes for the test year.

The Department claimed that Minnegasco's forecast contained data errors, did not properly adjust for price shocks, and inappropriately utilized a 20 year moving average to forecast weather. However, the Department believed that the Company's forecasted sales volumes are not too low, since the Department's own studies produced lower demand forecasts. As a result of its analysis, the Department recommended acceptance of Minnegasco's forecasted sales volumes in this rate case. The Department also recommended that the Commission state that it is not endorsing the forecasting method used by the Company.

The ALJ found that the level of Minnegasco's test year forecast is reasonable.

The Commission finds that Minnegasco's forecasted sales volumes are reasonable and will adopt them for this proceeding. The Commission also finds that there is not sufficient evidence in the record to determine what method is most appropriate for forecasting Minnegasco sales volumes.

B. Class Cost of Service Study

1. Introduction

The purpose of the Class Cost of Service Study (CCOSS) is to make a reasonably accurate determination of the nature and levels of costs incurred by the Company in providing service to each of its customer classes. This information is used, along with non-cost factors, in dividing responsibility for recovering the Company's revenue requirement among the classes, and in determining rate structure within the classes.

The CCOSS is calculated by functionalizing all the utility's costs, classifying them into cost categories, and allocating them among the classes. Disputes over the proper way to conduct a CCOSS generally relate to either the classification of costs or the allocation of costs.

Broadly speaking, three cost classifications are recognized for local gas distribution companies:

- Demand-related (or capacity-related) costs
- Energy-related (or commodity-related) costs
- Customer-related costs

Demand-related costs vary primarily with the maximum rate of flow of gas, energy-related costs vary primarily with the total volume of gas flowing, and customer-related costs vary primarily with the nature and number of customers.

Minnegasco provides firm sales service to two classes: Residential and Commercial & Industrial (C&I). Two classes receive interruptible sales service: Small Volume Dual Fuel (SVDF) and Large Volume Dual Fuel (LVDF). In addition, Minnegasco offers Firm Transportation service to its C&I customer classes, and provides interruptible transportation service to its SVDF and LVDF customer classes. Minnegasco also offers Market Rate (flexible rate) service to its sales and transportation customers in the SVDF and LVDF customer classes.

Service to interruptible sales customers may be curtailed by Minnegasco when immediately available gas supply is insufficient to serve both firm and interruptible loads. Similarly, Minnegasco may curtail service to interruptible sales and transportation customers when delivery capacity is insufficient to serve both firm and interruptible loads.

Minnegasco currently provides service in three separate rate areas: the Minnegasco-Minnesota rate area, the Midwest Gas-Northern Natural rate area and the Midwest Gas-Viking rate area. Minnegasco provided a separate cost study for each of the three areas.

MEC proposed three adjustments to the Company's cost allocations in the CCOSS for the Minnegasco-Minnesota rate area. MEC did not address the CCOSS, rates or revenue apportionment in the two rates areas formerly served by Midwest Gas.

2. Allocation of Conservation Improvement Program (CIP) Project Costs

Minnegasco allocated CIP costs to all customer classes based on annual throughput volume. The Department agreed with Minnegasco's method of allocating these costs. MEC proposed allocating CIP costs directly to the customer classes whose members are eligible to participate in CIP projects.

a. Positions of the Parties; the ALJ

Minnegasco Minnegasco argued that CIP projects lower energy costs for all of its customers by lowering project participants' peak-month energy use which helps Minnegasco improve its system-wide load factor. Minnegasco argued that a higher load factor helps it buy more economical gas supplies and lowers gas costs for all of its customers.

Minnegasco also argued that allocating CIP costs to all of its customers would be consistent with how CIP costs were treated in its last rate case, in Docket No. G-008/GR-92-400, and with how Peoples Natural Gas Company was allowed to recover its CIP costs, in Docket No. G-011/GR-86-144⁴.

The Department The Department argued that energy conservation, which is the intended result of CIP projects, is a direct substitute for additional gas supplies and lowers energy costs for all of the Company's ratepayers. The Department pointed out that MEC's witness admitted that if Minnegasco's customers consume less gas on-peak interruptible customers were less likely to be curtailed.

The Department also argued that CIP indirectly benefits all customers through the development of technologies for conservation, the sharing of information gained from the implementation of conservation programs, and through environmental benefits and resource conservation.

MEC MEC argued that CIP project costs should only be recovered from the customer classes that the CIP projects were designed for. MEC argued that most of the Company's CIP projects are designed for Residential and C&I customers and that CIP projects only lower gas costs for CIP program participants.

MEC argued that its proposed cost allocation would be fair because customers should not have to pay for projects they can not participate in and from which they can not directly benefit.

MEC proposed allocating CIP costs so that 27.8% are allocated based on firm design day sales and 72.2% are allocated based on annual sales volumes excluding interruptible sale volumes. MEC believes these percentage allocations are appropriate since 27.8% of the Company's cost of gas is demand related and 72.2% of the Company's cost of gas is commodity related. MEC believes it is fair to limit the contribution interruptible sales customers make to CIP cost recovery and that since interruptible transportation customers do not buy gas from Minnegasco they should not have to pay for any of these costs.

The ALJ The ALJ found that the allocation of CIP costs to all customer classes was reasonable because CIP projects lower gas costs for all ratepayers. The ALJ also found that CIP projects reduce on-peak demand for gas which reduces the number of cold weather curtailments for interruptible customers. The ALJ found this was an indirect benefit of CIP projects for large volume interruptible customers. The ALJ also found that CIP projects indirectly benefit all customers by encouraging the development of conservation technologies and dissemination of conservation information as well as by reducing harmful emissions and causing environmental

⁴ The Commission found that it was appropriate to allocate CIP project costs to all ratepayers in Peoples Natural Gas Company's 1986 rate case, in Docket No. G-011/GR-86-144. In its January 16, 1987 Order in that docket the Commission stated that it was

.. persuaded that the cost of conservation programs should be allocated to all customer classes based on energy usage. The Commission agrees with the finding of the ALJ that conservation programs provide systemwide benefits; therefore, all ratepayers should share in the cost of these programs. The Commission recognizes that conservation programs conserve energy resources, thereby holding down energy costs for all customers on the system. The Commission also concurs with the ALJ and the RUD-OAG that the Legislature perceived a public benefit in these programs that extends beyond direct participants.

In addition, the Commission finds that benefits accrue to customers roughly in proportion to their energy usage and that the primary impact of conservation will be in energy savings. Thus, energy usage is the most appropriate allocator for these costs. The Commission will direct the company to classify conservation costs as 100 percent energy-related and to allocate these costs on a uniform per Ccf basis to all classes. p. 54

benefits.

b. Commission Action

The Commission agrees with the ALJ and finds that CIP project costs lower costs for all ratepayers. In some instances costs are lowered directly through participation in CIP programs and in others the relationship between CIP projects and cost is less direct. The Commission finds that all Minnegasco ratepayers benefit indirectly from CIP through the development of new technology, the dissemination of conservation-related information and improvements to the environment from reduced energy consumption.

The Commission believes that since all of Minnegasco's ratepayers benefit from these programs, either directly or indirectly, all of Minnegasco's ratepayers should continue paying for the cost of these programs on a volumetric basis.

3. Allocation of Distribution System Capacity Costs

a. Positions of the Parties; the ALJ

Minnegasco Minnegasco allocates distribution system capacity costs using a two-step process. First, Minnegasco conducts a minimum size study to determine the minimum size main necessary to connect all of its customers to the distribution system. Mains are priced at book value and the cost is classified as a customer cost.

Second, Minnegasco allocates the remaining capacity costs using the average-and-peak method of cost allocation. Some of the remaining capacity costs are allocated on a proportional basis to all customer classes based on average use of the distribution system. The rest of the capacity costs are allocated proportionally to the customers who use the system during on-peak periods.⁵

In its brief, Minnegasco argued that:

Minnegasco uses the average-and-peak method because these capacity costs relate to both peak usage and average usage of the system. Minnegasco recognizes this dual purpose of the system by using a two-part formula in allocating system capacity costs which recognizes both: 1) the average use of capacity, and 2) responsibility for the capacity required to meet the maximum system demands.

The Department The Department argued that Minnegasco's system must be designed to meet the needs of its firm customers during peak periods. However, the Department argued that this task becomes more difficult and complicated the closer you get to the individual customer because not all customers peak at the same time. In fact, at the customer level, Minnegasco's system is designed to meet customers' "non-coincident" peak demand.

The Department argued that a perfect cost allocation system would identify what part of Minnegasco's system was designed to meet system peak requirements and would allocate that part of the system cost on the basis of firm-peak demand (coincident demand method). The remainder would be allocated to all customer classes based on each individual customer class's peak requirements (non-coincident peak demand).

The Department suggested that it is very difficult in practice to identify which specific components of the distribution system are designed to meet coincident versus non-coincident peak demand and that Minnegasco has not separated its distribution system costs to this level of

⁵ Minnegasco modified its CCOSS based on a recommendation by MEC and supported by the Department so that the peak part of the average-and-peak cost allocation would only allocate "peak" costs to firm customers based on firm customers' peak demand. Minnegasco's original proposal was to allocate the peak portion to all firm and interruptible customers based on system peak demand.

detail. The Department believes that since the average-and-peak method recognizes the difference between system specific and customer specific capacity costs it is an appropriate method for Minnegasco to use.

RUD-OAG The RUD-OAG argued that Minnegasco's system is designed to transport gas to all customers, including interruptible customers. The RUD-OAG argued that it is appropriate to allocate some capacity costs to interruptible customer classes because the Company incurs capacity costs off-peak on their behalf. The RUD-OAG argued that Minnegasco's application of the average-and-peak method fairly allocates capacity costs to interruptible customers.

The RUD-OAG argued that it would only be reasonable for interruptible customers to avoid all capacity costs in excess of the amount determined by the minimum distribution system study if these customers could show they receive no benefit from Minnegasco's larger-than-minimum distribution system.

The RUD-OAG also argued that the Commission has allowed LDCs to use the average-and-peak method in the past. In Peoples Natural Gas Company's 1986 rate case, in Docket No. G-011/GR-86-144, the Commission decided that interruptible customers were responsible for demand costs and stated in its January 16, 1987, FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER, that:

The Commission is persuaded that the Peak and Average Allocation method is the appropriate method for allocating demand-related transmission system costs. The Commission notes that under the Peak Average method, interruptible customers are allocated a portion of the demand-related costs. The Commission finds this appropriate because interruptible customers use the transmission system and should be allocated a portion of the costs. Order at p. 50.

The RUD-OAG also noted that the Commission allowed Peoples to continue using the average-and-peak method in its last rate case, in Docket No. G-011/GR-92-132, and that Minnegasco was allowed to use the average-and-peak method in its last rate case, in Docket No. G-008/GR-92-400.

The RUD-OAG distinguished the facts of this case from the Commission's decision to allow NSP to allocate capacity costs based on peak coincident demand in NSP's last rate case, Docket No. G-002/GR-92-1186. The RUD-OAG noted that the Commission's decision in the NSP case did not address whether NSP's interruptible customers benefitted from the actual physical configuration of NSP's distribution system. In this case, the RUD-OAG argued that the record established that interruptible customers benefit from the larger-than-minimum distribution system.

MEC MEC argued that capacity costs should be allocated entirely to firm customer classes based on firm-peak day demand (coincident peak demand method). MEC believes firm customers are the cause of Minnegasco's incurring these distribution system capacity costs because the system was designed to serve firm customers. MEC does not believe average system use should be a factor in determining how to allocate these costs.

MEC argued that its position is supported by the Commission's decision in the last NSP rate case, Docket No. G-002/GR-92-1186, in which the Commission allowed NSP to allocate all of its distribution system capacity costs to firm customers.

ALJ The ALJ found that it was reasonable for Minnegasco to allocate capacity costs in excess of the minimum distribution size using the average-and-peak method. The ALJ agreed with the arguments of the Company, the Department and the RUD-OAG because the average-and-peak method reaches a middle ground between allocating all of the costs to firm customers based on peak-day demand and allocating to all customers based on their actual use of the system.

The ALJ determined that Minnegasco's situation in this case is different from NSP's situation in

NSP's last rate case, in Docket No. G-011/GR-92-1186. The ALJ found that NSP's system is designed as an interconnected grid so that supplies and capacity can reach firm customers from many different directions. NSP's system in its entirety is designed to meet system requirements on-peak. NSP has not allocated any of these costs to customers using a minimum system study. On the other hand, Minnegasco's system is designed in a more hierarchical manner, with individual customer requirements controlling the Company's capacity costs the closer the system gets to the customer.

The ALJ also noted that in the NSP case there was no analysis of whether interruptible customers benefitted from NSP's system capacity. In this case it was determined that interruptible customers do benefit from a larger-than-minimum sized distribution system.

b. Commission Action

The Commission finds that it is appropriate for Minnegasco to continue using the average-and-peak allocation method for capacity costs that are in excess of the amount classified as customer costs using the minimum size study. The Commission finds this is appropriate because the average-and-peak method recognizes that some of these costs are incurred to provide service to firm customers on-peak and some of these costs are incurred to provide service to all customers regardless of when their peak-demand occurs. In addition, in this case, there has been a showing that interruptible customers benefit from Minnegasco's larger-than-minimum system and should be allocated a portion of the costs of having that system available to them.

The Commission also notes that its decision in the 1992 NSP rate case is not controlling in this docket because NSP and Minnegasco have designed their systems using different approaches. NSP has also been ordered to provide a minimum system study in its next rate case to determine what portion of its capacity costs should be classified as customer related costs.

4. Allocation of Peaking-Plant Operating and Maintenance (O&M) Costs

Minnegasco allocates peaking plant O&M costs to all customers on the basis of which customer classes were using Minnegasco's system while the peaking plants were in operation over the past five years. The Department and RUD-OAG agreed with Minnegasco.

MEC proposed allocating peaking plant O&M costs only to the firm customer classes in the same way peaking plant asset accounts are allocated to firm customers in rate base because the peaking plants were built to serve firm customers.

a. Positions of the Parties; the ALJ

Minnegasco Minnegasco allocated peaking plant O&M costs based on historical firm peak day usage. However, interruptible customers were also allocated a portion of these costs because interruptible customers sometimes receive service when peaking plants are in operation. Minnegasco believes this is appropriate because these customers cause some of these costs to be incurred.

The Department The Department argued that peaking plant O&M costs are incurred so that Minnegasco's peaking facilities can produce gas. The Department argued that O&M costs should be allocated to the customers that use gas while these plants are in operation. The Department found that over the past five years, 1989-1993, there were approximately 375 days on which interruptible customers were not curtailed when Minnegasco's peaking plants were in operation.

The Department found that Minnegasco curtails interruptible customers based on forecasted weather conditions and that actual weather conditions are often different from the forecast. The difference between actual and forecasted weather leads to higher demand for gas and the need to keep peaking plants in operation.

The Department believes fairness dictates that interruptible customers pay a share of peaking plant O&M costs.

RUD-OAG The RUD-OAG agreed with Minnegasco. The RUD-OAG believes it would be fair for interruptible customers to pay some of these costs because interruptible customers are not curtailed before peaking plants are put into operation.

MEC MEC argued that responsibility for peaking plant O&M costs should be assigned to the customer classes these plants were designed and built to serve. MEC does not believe a customer's actual gas usage while these plants are in operation should determine how these costs are allocated because the plants were built to serve firm customers. MEC argued that the allocation of peaking plant O&M costs should be consistent with the way peaking plant asset accounts are allocated to firm customers in rate base.

ALJ The ALJ found that interruptible customers are partly responsible for increasing O&M costs above the level which would result if only firm customers were served by these plants. The ALJ recommended allocating some of these costs to interruptible customers.

b. Commission Action

The Commission finds that it is appropriate for Minnegasco to allocate a share of the peaking plant O&M costs to interruptible customers since these customers often receive service while the peaking plants are in service. This enables interruptible customers to receive service without being curtailed and to benefit from the operation of these facilities.

C. Revenue Apportionment to the Customer Classes

1. Minnegasco's Proposal

Minnegasco proposed a revenue apportionment to the customer classes in its three rate areas that would accomplish several different objectives. Minnegasco's revenue apportionments would consolidate rates in the Minnegasco-Minnesota and Midwest Gas-Northern Natural rate area. The rate increase would be distributed so that most, if not all, class revenue responsibility would be more closely aligned with each class's cost of service according to the Class Cost of Service Studies.

Minnegasco also based its revenue apportionment on non-cost rate design objectives. First amongst these non-cost factors was the avoidance of rate shock for individual customer classes. The Company has also attempted to simplify its rate structure by combining the former Midwest Gas-Northern Natural rate area with its own rate area in an attempt to make the Company's rates more logical, understandable and easy to administer.

Minnegasco's proposal included some changes in how the consolidated Minnegasco-Minnesota and Midwest Gas-Northern Natural customer classes would be divided. The C&I customer class would be divided into three subclasses: segment A for customers who use less than 1,500 therms of gas per year; segment B for customers who use at least 1,500 but less than 5,000 therms of gas per year; and segment C for customers who use at least 5,000 therms of gas per year. The Small Volume Dual Fuel customer class would be divided into two subclasses: segment A for customers who use less than 120,000 therms of gas per year; and segment B for customer who use 120,000 or more therms of gas per year.

Minnegasco's proposal as modified by the Department's suggestion for dividing customer classes into subclasses and based on the \$10,972,000 rate increase contained in the Offer of Settlement and Stipulation of Facts would result in the following rate increases and decreases for the customer classes in the Company's three rate areas:

Minnegasco-Minnesota rate area

Residential	3.2%
Commercial & Industrial-A (Firm)	1.6%
Commercial & Industrial-B (Firm)	.2%
Commercial & Industrial-C (Firm)	.8%
Large General Service (Firm)	(10.2%)
Small Volume Dual Fuel-A (Interruptible)	2.4%
Small Volume Dual Fuel-B (Interruptible)	3.3%
Large Volume Dual Fuel (Interruptible)	.9%
Total	2.2%

Midwest Gas-Northern Natural rate area

Residential	(2.7%)
Commercial & Industrial-A (Firm)	7.2%
Commercial & Industrial-B (Firm)	(.2%)
Commercial & Industrial-C (Firm)	(3.5%)
Large General Service (Firm)	0.0%
Small Volume Dual Fuel-A (Interruptible)	(6.2%)
Small Volume Dual Fuel-B (Interruptible)	(8.4%)
Large Volume Dual Fuel (Interruptible)	(4.9%)
Total	(2.8%)

Consolidated Minnegasco-Minnesota & Midwest Gas-Northern Natural rate areas

Residential	2.4%
Commercial & Industrial-A (Firm)	2.2%
Commercial & Industrial-B (Firm)	.1%
Commercial & Industrial-C (Firm)	.5%
Large General Service (Firm)	(10.2%)
Small Volume Dual Fuel-A (Interruptible)	1.8%
Small Volume Dual Fuel-B (Interruptible)	2.4%
Large Volume Dual Fuel (Interruptible)	.7%
Total	1.7%

Midwest Gas-Viking rate area

Residential	3.5%
Commercial & Industrial-A (Firm)	5.9%
Commercial & Industrial-B (Firm)	.9%
Commercial & Industrial-C (Firm)	6.1%
Large General Service (Firm)	0.0%
Small Volume Dual Fuel-A (Interruptible)	6.3%
Small Volume Dual Fuel-B (Interruptible)	2.6%
Large Volume Dual Fuel (Interruptible)	4.8%
Total	3.8%

2. Positions of the Parties; the ALJ

a. The Department

The Department agreed with the revenue apportionments proposed by the Company. The Department believes the revenue apportionment furthers all of the Company's rate design goals by moving rates in the direction of costs while recognizing the importance of non-cost objectives such as the avoidance of rate shock.

The Department also suggested some refinements to Minnegasco's proposal for dividing customer classes into class segments. The Department recommended dividing the Midwest Gas-Viking C&I class into only two subclasses (one segment for customers who use less than 5,000 therms of gas per year and the other segment for customers who use 5,000 therms of gas per year or more) and dividing the Midwest Gas-Viking SVDF class into two subclasses along the same lines as the SVDF customer class in the consolidated rate area.

b. The RUD-OAG

The RUD-OAG agreed with the Company's proposed allocation of revenue responsibility. The RUD-OAG believes Minnegasco has proposed a reasonable rate design for its customers in this case based on cost of service as well as relevant non-cost factors. The RUD-OAG listed the following non-cost rate design factors: whether the rates would be disruptive; the impact of rates on the Company's revenue stability; whether the rates are affordable; the Company's ability to pass rate increases on to others; and the customer's ability to decrease the burden of a rate increase through tax deductions.

c. MEC

MEC opposed the Company's revenue apportionment and argued that revenue apportionment should be based strictly on the Class Cost of Service Study.

MEC tempered its recommendation by suggesting that increases in class revenue responsibility should be limited to 15% to avoid rate shock. MEC argued that this was the only way to align rates with costs and to eliminate the historic subsidization of residential and small business customers by all of the Company's other customers.

MEC argued that there is nothing in the record of this case that supports the existence of non-cost factors, such as rate shock, since MEC's witness was the only one to provide testimony on what size rate increase, i.e. 15%, would actually cause rate shock to occur.

In addition, MEC excepted to the ALJ's revenue apportionment recommendation because the subsidy for the residential customer class would increase from the subsidy proposed in the Company's original filing.

d. ALJ

The ALJ found that MEC's proposed revenue apportionment reflected too little concern for the possibility of rate shock. The ALJ found that MEC's proposal was inconsistent with traditional revenue apportionment methods and ignored important non-cost related rate design principles.

The ALJ recommended the Commission adopt Minnegasco's proposed revenue apportionment because the apportionment would move rates in the direction of cost while recognizing all of the Company's cost-related and non-cost based rate design goals.

3. Commission Action

MEC has failed to persuade the Commission that the Company's revenue apportionment is outside the range of acceptable regulatory practice so that the resulting rates would be unfair and

unreasonable. Judgments as to what constitutes rate shock and how far and how rapidly the Commission should move toward cost-based rates are uniquely legislative decisions left to the Commission's sound discretion. In addition to cost, there are other important rate design considerations. As the Minnesota Supreme Court has stated:

Once revenue requirements have been determined, it remains to decide how, and from whom, the additional revenue is to be obtained. It is at this point that many countervailing considerations come into play. The Commission must balance factors such as cost of service, ability to pay, tax consequences, and ability to pass on increases in order to achieve a fair and reasonable allocation of the increase among the customer classes. St. Paul Area Chamber of Commerce vs. Minnesota Public Service Commission, 251 N.W. 2d 350 (1977).

The Commission has recognized that moving prices toward cost is a reasonable policy. The Commission generally supports the movement toward cost-based pricing, but recognizes that there are other non-cost factors that are equally important. For example, the Commission has stated:

Avoiding rate shock is a primary ratemaking goal, because sudden, drastic increases in energy costs can be burdensome for residential and non-residential ratepayers alike. Avoiding rate shock is particularly important for residential ratepayers, however, because increases in the cost of basic needs can cause hardship for customers on low or fixed incomes. In the Matter of the Application of Midwest Gas, a Division of Iowa Public Service Company, for Authority to Change Its Schedule of Gas Rates for Retail Customers within the State of Minnesota, Docket No. G-010/GR-90-678, FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER (July 12, 1991), p. 35.

The Commission finds that MEC's proposed revenue apportionment would be too large and abrupt a movement towards a strictly cost-based revenue apportionment. The Commission notes that the record in this case contains extensive comment and public testimony from members of the public opposing any increase in rates for residential customers.

Furthermore, the Commission finds that the stipulated reduction in the Company's revenue requirement does not necessarily have to lower the cost of service for each customer class in equal proportion as MAC had suggested. The Commission recognizes that the appropriate relationship between class cost of service and class revenue responsibility is not fixed by the Company in its initial filing and may change depending on the decisions made by the Commission after taking into consideration various cost and non-cost factors.

The Commission finds that the class revenue apportionments proposed by the Company in the Offer of Partial Settlement and Stipulation of Facts, and recommended by the Department, the RUD-OAG, and the ALJ are reasonable. The Commission recognizes that the actual class revenue increases and decreases will be smaller but in approximately the same proportion as the increases and decreases described in the Offer. These increases and decreases will be made smaller according to the Commission's revenue requirements decisions in this docket.

D. Rate Design for the Large Volume Dual Fuel (LVDF) Customer Classes

1. Introduction

Minnegasco's Large Volume Dual Fuel (LVDF) customer class contains all of Minnegasco's interruptible customers who use at least 2,000 therms of gas per day. Minnegasco offers four tariffed services to these customers: interruptible sales service, market rate sales service, interruptible transportation service and market rate transportation service. LVDF sales and transportation customers pay the same non-gas unit margin which is called the standard rate or the delivery charge. LVDF market rate customers pay a negotiated rate (non-gas unit margin) that falls within a range of rates approved by the Commission pursuant to Minn. Stat. § 216B.163.

2. Standard Rate for the LVDF Customer Class

a. Positions of the Parties; the ALJ

Minnegasco Minnegasco proposed to increase the LVDF standard rate (delivery charge) to \$.04946 per therm in all three of its rate areas, based on the original \$22.7 million rate increase request. This rate was based on a 1.5% increase in the revenue responsibility for the LVDF customer classes.

The increase in the revenue responsibility for the consolidated LVDF customer classes in the Minnegasco-Minnesota and Midwest Gas-Northern Natural rate areas would be .7% based on the revenue requirement proposed in the Offer of Partial Settlement and Stipulation of Facts.

Minnegasco argued that non-cost based rate design objectives are important factors in addition to cost of service in evaluating rate design proposals for this customer class. In particular, Minnegasco noted the avoidance of rate shock for all of its customers as being important.

The Department The Department agreed with the Company's proposed rate for the LVDF customer class. The Department does not believe MEC's analysis adequately considered the revenue responsibility of this customer class in relation to Minnegasco's Residential and small C&I customers.

The Department objected to MEC's rate design proposals because they were based on MEC's CCOSS adjustments which the Department opposed. In addition, the Department argued that MEC's analysis was limited to rates for the customers in the Minnegasco-Minnesota rate area and did not take into account Minnegasco's proposal to consolidate rates.

The RUD-OAG The RUD-OAG opposed MEC's suggestion that rates should be designed only on the basis of cost of service. The RUD-OAG argued that such a rate design would be contrary to state law and sound public policy. The RUD-OAG argued that the Minnesota Supreme Court has expressly stated that both cost and non-cost factors must be considered when the Court rejected an argument that cost of service was the most important rate design objective:

The appellants' argument that the cost of providing service should be the single most important consideration in the setting of utility rates undervalues the PUC's obligation to also review and balance non-cost factors when determining revenue responsibilities for different classes of customers. This court has recognized that rate levels for a class must ultimately be the product of many countervailing considerations, including non-cost factors as well as the results of cost studies. Reserve Mining and Minnesota Public Utilities Commission, 334 N.W. 2d 389, 393 (Minn. 1983).

MEC MEC proposed a standard rate of \$.01512 per therm based on MEC's proposed adjustments to the Company's CCOSS and customer class revenue apportionment. Based on Minnegasco's original \$22.7 million request this would translate into a 10.67% decrease in revenue responsibility for this customer class.

ALJ The ALJ found that MEC's proposed LVDF standard rate was inappropriate because it was based on proposed CCOSS modifications which were inappropriate. The ALJ also found that MEC's proposal to base rates entirely on the CCOSS should not be approved because it would ignore important non-cost based rate design objectives.

The ALJ found that Minnegasco's proposed method of adjusting the LVDF rate in recognition of the reduced revenue requirement in the settlement and stipulation was appropriate because Minnegasco's method would lower the percentage rate change for all customer classes and would satisfy the rate design goals of rate moderation and customer acceptance.

b. Commission Action

According to the Company's revised CCOSS, the settled and stipulated revenue requirement (which has been modified by this Order) and the Company's proposed revenue apportionment, the LVDF customer class in the consolidated Minnegasco-Minnesota and Midwest Gas-Northern Natural rate area would be paying approximately 2.6% more in rates than its cost of service. The only other customer class in the consolidated rate area with a class revenue responsibility more closely aligned with cost is the mid-sized C&I (segment B) customer class.

The Company, the Department and the ALJ all agreed that there are important rate design objectives that the Commission should consider besides cost causation in determining appropriate rates for a particular customer class. The Company, the Department and the ALJ also agreed that a sudden move to cost based rates for the Residential and small C&I (segment A) customer classes, which would be necessary for MEC's rates to be adopted, would cause rate shock and would not be in the public interest.

The Commission agrees with the arguments made the Company, the Department and the ALJ and will adopt the Company's proposed rate design for the LVDF customer class.

3. Minimum and Maximum Allowable Market (Flexible) Rates for the LVDF Customer Class

a. Positions of the Parties; the ALJ

Minnegasco Minnegasco proposed to leave the minimum market (flexible) rate unchanged at \$.005 per therm and to increase the maximum flexible rate from \$.08430 to \$.09392 per therm.

Minnegasco argued that its \$.005 per therm minimum rate would recover incremental cost as required by Minn. Stat. § 216B.163, subd. 4 (1), and was approved previously, in Docket No. G-008/M-87-331, and in the Company's last rate case, in Docket No. G-008/GR-92-400.

Minnegasco proposed an increase in the maximum flexible rate to maintain a range above the standard non-gas unit margin equal to the range below the standard margin. The Company argued that this relationship between the standard margin and the minimum and maximum rate is appropriate because it is the same relationship between rates that the Commission approved for all gas utilities when the Commission first set maximum rates.

Minnegasco objected to MEC's proposal to design minimum and maximum flexible rates using the straight-fixed-variable⁶ (SFV) rate design method because it does not address appropriate rate design objectives. Minnegasco does not believe SFV rate design can be easily used at the local distribution company level of the gas industry even though the Federal Energy Regulatory Commission (FERC) has mandated this rate design method for the interstate gas pipeline industry. Minnegasco also objected to MEC's proposal because the derivation of MEC's proposed rates was not clearly explained.

The Department The Department did not object to Minnegasco's proposal to maintain the minimum rate at \$.005 per therm and to increase the maximum rate.

The Department objected to MEC's straight-fixed-variable rate design proposal for several reasons. MEC has not shown that the benefits of switching to straight-fixed-variable rate design by the interstate pipelines would be duplicated at the local distribution company level of the gas industry. MEC did not explain why the Commission's policy should change from setting the maximum rate as high above the standard margin as the minimum rate is set below the standard

⁶ A common definition of straight-fixed-variable (SFV) rate design is: an interstate pipeline transportation rate design that includes all of the fixed costs as part of the reservation charge. (Under the modified fixed variable (MFV) rate design method, which was the method most recently used by the FERC prior to Order 636, costs were divided and some of the fixed costs were allocated back to the demand charge.)

margin. MEC did not show that its minimum rate would recover Minnegasco's incremental cost of service to these customers. Finally, MEC did not explain how it separated fixed costs from variable costs in its rate calculations.

RUD-OAG The RUD-OAG does not believe MEC has shown that the public interest would be served or that it would be reasonable to permit LDCs to use SFV rate design for setting minimum and maximum flexible rates. The RUD-OAG argued that since there are significant differences between interstate pipelines and local distribution companies, the FERC's SFV rate design mandate, contained in its Order 636, does not necessarily fit the needs of LDCs in Minnesota.

MEC MEC proposed setting the minimum LVDF flexible rate at \$.00251 per therm. MEC believes this rate would recover the Company's variable cost of providing service. MEC believes it has determined the Company's variable cost of service for these customers by using a SFV costing analysis.

MEC believes that SFV costing will promote the use of natural gas over alternate fuels such as foreign oil. MEC also argued that SFV rate design will lower gas rates for LVDF market rate customers by removing fixed costs from the rates they pay.

MEC also argued that LDCs should use SFV costing because the Federal Energy Regulatory Commission required all of the interstate pipelines to use SFV rate design in the pipeline Restructuring Rule (Order 636).

MEC proposed setting the maximum LVDF flexible rate at \$.02124 per therm. MEC argued in direct testimony that the maximum rate should equal the firm delivery charge (calculated as if Minnegasco's year-round load factor were 100%) plus the variable (or incremental) cost as determined by its calculation of the minimum rate. MEC believes this is appropriate because this method is the approach the FERC uses in determining maximum interruptible interstate pipeline transportation rates.

In briefs, however, MEC argued that the SFV method should be used to determine the maximum rate. MEC argued that SFV costing was necessary because Minnegasco's rates are higher than pipeline rates for transporting gas for similar distances. MEC argued that Minnegasco's LVDF rates are not competitive with other LDCs' rates.

ALJ The ALJ recommended approval of Minnegasco's \$.005 per therm minimum flexible rate. The ALJ found that Minnegasco's minimum flexible rate recovers the incremental cost of providing service, as required by Minn. Stat. § 216B.163, subd. 4 (1), and was reasonable. The ALJ relied on the Commission's previous determinations, first in 1987, in Docket No. G-008/M-87-331, when Minnegasco's flexible rates were first established, and in the 1992 rate case, in Docket No. G-008/GR-92-400, in which the \$.005 per therm minimum rate was approved again.

The ALJ found that MEC's recommendation for minimum and maximum flexible rates determined using a SFV rate design methodology was inappropriate. The ALJ found that MEC had not shown that SFV costing would meet appropriate rate design goals. The ALJ was also concerned about applying this methodology to only one rate component for one customer class.

b. Commission Action

The Commission believes that a switch to SFV rate design would be a very significant policy change for this utility and its customers. It should only be undertaken if there is sufficient evidence that minimum rates under SFV rate design would not conflict with Minnesota law and that SFV rate design would be good public policy. These questions have not been fully developed in this case.

The Commission finds that Minnegasco's incremental cost of service for the LVDF customer class is lower than its proposed minimum flexible rate of \$.005 per therm as determined in previous Commission proceedings. The Commission does not find cause in this proceeding to adjust the Company's minimum rate.

In addition, the Commission finds it is appropriate in this case for the Company to keep the maximum flexible rate set as high above the standard rate as the minimum rate is below the standard rate. This maintains the historical relationship between the minimum and maximum rate and allows the Company to make up lost margins between rate cases if the price of alternative fuels should rise above the Company's standard rate.

The Commission may investigate the setting of minimum and maximum rates further in the Company's next rate case.

E. Consolidation of Rates in the Minnegasco-Minnesota and Midwest Gas-

Northern Natural Rate Areas

1. Minnegasco's Proposal

Minnegasco proposed to consolidate rates for all of its customers served off of the Northern Natural Gas Company (Northern Natural) interstate pipeline. Consolidation would allow Minnegasco to charge all of its customers in the two rate areas that are in the same customer class:

- the same monthly customer charge
- the same non-gas unit margin
- the same cost of gas
- the same PGA

Consolidation also means that all of the remaining Midwest Gas tariffs that haven't been merged into or made to conform with Minnegasco's existing tariffs could be consolidated at the end of this case.

2. Positions of the Parties; the ALJ

a. The Department

The Department agreed with the Company's proposal to consolidate rates because the costs associated with serving the two rate areas are reasonably similar. The Department noted one exception, pipeline demand costs. This exception was addressed in the Settlement portion of this case.

b. ALJ

The ALJ determined that no party disputed Minnegasco's proposal to consolidate rates and PGAs for the two rate areas. The ALJ found that Minnegasco's proposal was reasonable and should be adopted.

3. Commission Action

The Commission finds that it would be reasonable to allow Minnegasco to consolidate rates for its customers in these two rate areas. The Commission finds that the costs associated with serving these customers are similar and that maintaining separate rate structures for the two areas is not warranted. In addition, the Commission finds that consolidation would further the rate design goal of making the Company's rates logical, understandable and easy to administer.

F. Residential Customer (Renamed Basic) Charges

1. Positions of the Parties

The Company proposed to raise the residential customer charge, the fixed monthly charge residential customers pay regardless of usage, to \$6 per month. The Company explained that its class cost of service study placed the fixed costs of serving the average residential customer between \$13 and \$15 per month and that the increase proposed in this case was part of a long term strategy to align customer charges more closely with fixed costs. The proposed increase would amount to \$2 for former Midwest Gas customers and \$1 for other customers.

The Department and the RUD-OAG concurred in the proposed increase. The Department recommended requiring the Company to design and conduct a public education program explaining how customer charges work. The RUD-OAG and the Company agreed with this recommendation.

The Suburban Rate Authority (SRA) challenged the increase as undermining conservation

incentives and urged the Commission to establish a permanent cap on residential customer charges, expressed as a percentage of the average residential bill.

The Administrative Law Judge recommended approving the proposed increase. He found that it would promote efficient use of resources by sending more accurate price signals, increase overall fairness by placing a more equitable share of fixed costs on low usage customers, and increase revenue stability. He found that the Order in the Company's last rate case approved customer charge increases for these reasons. He recommended requiring the Company to conduct the public education program recommended by the Department.

The Administrative Law Judge found no evidence in the record to support the SRA's claim that customer charges tend to neutralize conservation incentives. He also rejected the SRA's recommendation that the Commission establish a policy limiting customer charges to specified percentages of total bills in the future.

2. Commission Action

Having examined the record as a whole, including the public comment file, the Commission concludes the Company's residential customer charge proposal is not in the public interest. The Commission will authorize a \$1 increase in the customer charge of former Midwest Gas customers to equalize the customer charges of all Minnegasco customers. No other increase in the residential customer charge will be approved.

There are two main reasons for this action. First, the confusion and annoyance expressed by residential ratepayers at the prospect of a higher customer charge have underscored the importance of making residential rates understandable and credible to those who pay them. Second, charges unrelated to usage do conflict with conservation incentives, and the Commission is unwilling to send this anti-conservation signal to the residential class. These reasons will be discussed in turn.

a. Customer Acceptance

Five of the seven ratepayers who spoke at the public hearings in this case identified the proposed increase in the residential customer charge as a major concern. The Administrative Law Judge reported that 75 members of the public wrote or called about this case and that "[i]ncreasing customer charges came under greater attack than any other single proposal. . . ." The letters in the public file consistently object to paying baseline costs independent of usage, complaining that they do not have to pay other businesses for standing ready to serve.

The Department felt enough concern about public acceptance to recommend requiring the Company to conduct a public education program on customer charges. The RUD-OAG, the Company, and ultimately, the Administrative Law Judge, agreed with this judgment.

The Commission does not see an education program as the best response to this kind of public resistance to increasing the customer charge. In residential ratemaking making rates understandable, making them easy to administer, and maintaining public confidence in their fairness are cardinal goals. Making rates consistent with regulatory theory is a subordinate goal, unless the principle at issue has such a fundamental effect on fairness or public policy that it must be given priority.

This is so because consumers, unlike businesses, cannot be expected to place a high priority on understanding energy pricing policies. They expect, and deserve, high quality energy services priced in a familiar and understandable manner. The distinction between fixed and variable costs underlying the customer charge is not familiar or readily understandable to consumers.

None of the reasons for increasing the customer charge -- better resource allocation through more accurate price signals, greater revenue stability, fairer distribution of fixed costs -- reach a level of importance that would justify adopting a rate design customers clearly find confusing.

While the Commission respects the effectiveness of well-designed customer education programs, it is advisable to concentrate educational efforts on issues that more directly affect the public interest, such as safety and conservation. Trying to convince consumers they should think about natural gas prices in regulatory terms would consume resources, creativity, and goodwill which could be put to better use.

b. Effect on Conservation

Under Minn. Stat. § 216B.03 (1992) the Commission is to set rates to encourage conservation "[t]o the maximum reasonable extent." This requirement limits the usefulness of customer charges in residential ratemaking in this case.

The Administrative Law Judge is correct in noting that the relationship between conservation and residential customer charges is not fully developed in the record. However, the public testimony confirms the Commission's belief, based on its own experience and expertise, that customer charges do tend to neutralize conservation incentives in the minds of residential customers.

The Administrative Law Judge reported that one residential customer who testified at the public hearings stated she used to shut off her gas during the summer, but now "felt that conserving energy was useless because customers would still be billed for the customer charge even if they used no gas. . . ." Finding 21, ALJ's Report. Letters in the public file echo this sentiment, with customers expressing frustration that the increased customer charge and proposed Weather Normalization Adjustment would diminish their ability to control costs by controlling usage.

The Commission sees this reaction as a serious obstacle to heightening conservation awareness, a policy goal it has been pursuing for over a decade. The revenue stability and resource allocation goals served by higher customer charges will have to yield in this case to the statutory goal of encouraging conservation to the maximum reasonable extent.

The Commission appreciates the parties' and the Administrative Law Judge's close attention to the last Minnegasco rate case Order and the policy rationale it articulated for the customer charge increases approved there. The decision in that case was fact-specific, however, as the decision in this case must be. For the reasons set forth above, the Commission will not approve residential customer charge increases beyond the one intended to bring the rates of former Midwest customers into parity with other customers' rates.

c. Future Policy Left for Future Decision

The SRA asked the Commission to establish a long term policy on residential customer charges limiting them to a fixed percentage of the average residential bill. The Commission agrees with the Administrative Law Judge that this would be inappropriate.

Rate design decisions are legislative in nature and must turn on the facts and circumstances of the case in which they are made. The Commission will not limit its ability, or the ability of any future Commission, to tailor future rate design decisions to the situation at hand.

G. Other Customer (Renamed Basic) Charges

The concerns set forth above do not apply with equal force to non-residential customers. The Commission therefore accepts and adopts the Administrative Law Judge's findings, recommendations, and rationale on non-residential customer charges.

H. Demand/Commodity (Three-Part Rate) Billing Option for C&I Customers

The Company proposed making the three-part rate for Large Volume C&I (Large General Service) customers available to its C&I customers on an optional basis. The Department and the RUD-OAG objected to Minnegasco's proposal for an optional three-part C&I rate for various

reasons and recommended the Company withdraw its proposal. Minnegasco did not dispute the Department's or the RUD-OAG's recommendation. The Commission finds that it would be reasonable to allow Minnegasco to withdraw its proposal for an optional three-part C&I rate.

I. Collection of Customer Load Information

In addition to developing a seasonal rates proposal for parties to review in the Company's next rate case, Minnegasco will collect load factor and maximum daily use data for all of the C&I and SVDF customer classes.

However, this information may not be complete prior to the Company's next rate filing and the completion of the Company's CIP project, the Load Research Study. The Company has indicated that it would like to delay gathering this information until it can use some of the metering equipment that was purchased for the Load Research Study. The equipment may not be available until that program is completed.

The Commission finds this timing is reasonable.

J. Compliance with Market (Flexible) Rate Tariffs

During its initial investigation the Department received a response to one of its information requests that appeared to show that Minnegasco was flexing its market sales rates below the approved minimum rate. However, the Company had put information covering flexible rate sales and transportation customers in its response to the information request. The data the Department thought only applied to sales customers really applied to both sales and transportation customers. Some of the data in the Company's response included gas costs and some of the data did not.

As a result of this clarification the parties agreed that:

- Minnegasco's flexible tariff practices were consistent with its applicable tariffs
- Quarterly reports on Minnegasco's market rates are not necessary

The Commission agrees that Minnegasco's practices were consistent with applicable tariffs and that quarterly reports are not necessary.

K. Gas Purchasing Incentive Mechanism

1. Introduction

a. The Filings

In its original rate case filing, Minnegasco proposed the recovery of an acquisition adjustment for the amount it paid in excess of book value for Midwest Gas Company. The Department and the RUD-OAG filed testimony recommending a denial of the acquisition adjustment. The agencies argued that there were no demonstrable savings to the former Midwest and Minnegasco customers resulting from the acquisition.

The deadline for filing a request for intervenor status in the rate case was March 14, 1994.

On April 22, 1994, in its rebuttal testimony, Minnegasco submitted a gas purchasing incentive (GPI) mechanism proposal as an alternative to the acquisition adjustment.

On May 2, 1994, the Department filed comments in opposition to the GPI in surrebuttal testimony. In surrebuttal testimony filed May 20, 1994, the RUD-OAG also recommended rejection of the GPI proposal.

In settlement negotiations, the Department, the RUD-OAG, and the Company agreed that

Minnegasco would withdraw its request for rate base treatment of the acquisition adjustment. The parties further agreed that they would litigate the GPI proposal as an alternative means for Minnegasco to recover its investment over book value in Midwest Gas.

b. The GPI Proposal

The Company stated that its GPI would allow it the opportunity to recover the Midwest Gas acquisition adjustment, to the extent of gas cost savings that can be attributed to the acquisition.

Under the proposal, the Company would calculate the historical difference in the cost of gas between Midwest-Minnesota (Northern Natural rate area only) and Midwest-Iowa from July, 1991, to August, 1993. This cost differential would be added to the current Midwest-Iowa cost of gas to arrive at the benchmark, or proxy, for what Midwest's cost of gas would have been if Midwest were still operating in Minnesota.

The difference between the benchmark and Minnegasco's consolidated cost of gas would be multiplied by the actual gas volume sold to former Midwest customers served off the Northern Natural pipeline (MW-NNG customers) to determine the annual level of savings.

In the following year, Minnegasco would collect 75% of the total savings from the MW-NNG customers through the purchased gas adjustment (PGA).

Minnegasco proposed to make its first annual GPI filing on September 1, 1995, and to keep the GPI in effect indefinitely. The recovery under the GPI would not be capped by the amount of the acquisition adjustment.

2. Comments of the Parties; the ALJ

a. Minnegasco

Minnegasco argued that its gas purchasing incentive proposal should be approved because it is non-speculative, it would share savings with customers, and it would provide an incentive for the Company to recover some of its acquisition costs.

Minnegasco stated that its rates for gas service would not reflect any costs associated with the acquisition adjustment unless cost of gas savings are actually produced by Minnegasco for the former Midwest customers.

Minnegasco argued that notice issues should not cause rejection of the proposal because the incentive is not meant to be generic but is a pilot only.

b. The Department

The Department contended that the gas purchasing incentive proposal should be rejected because it had been filed after the rate case intervention deadline. This meant that potentially interested parties had not had notice of the issue or the opportunity to join the proceedings to comment on the proposal. Parties in the rate case had also not had adequate time to develop the issues properly.

The Department also argued that the proposal should be rejected on the merits. The Department stated that it advocates gas cost incentives; this is not, however, a true incentive. The Department argued that the incentive proposal does not provide a true reward for a change in future gas purchasing practices. The consolidation of rates shifts gas-related demand costs from former Midwest customers to all of Minnegasco's customers served off the Northern pipeline. This shift substantially reduces the former Midwest customers' gas costs in comparison to a proposed proxy without reducing Minnegasco's overall costs.

The Department also questioned the legality of recovery of the incentive through the PGA.

c. RUD-OAG

The RUD-OAG submitted six recommended criteria by which to measure this GPI's effectiveness: lowers costs for all customers; is consistent with gas industry developments; provides a true incentive; is susceptible of evaluation; maintains or improves quality of service; rewards good utility performance, penalizes poor performance. According to the RUD-OAG, Minnegasco's proposed GPI fails analysis under all six criteria.

d. Suburban Rate Authority

The SRA stated that Minnegasco should be held to a strict standard of pre-intervention notice regarding substantive proposals that affect rates.

e. The ALJ

The ALJ recommended rejection of the proposal for four main reasons: 1) the proposal was filed too late for meaningful participation; 2) incentive payments would be received only from customers in territory acquired from Midwest; 3) unlike this proposal, a good incentive will result in actions which would not be taken without the incentive; 4) Minnegasco failed to quantify administrative costs of the proposal.

3. Commission Action

a. Background

On May 4, 1994, the Commission issued its ORDER DECLINING TO ADOPT TWO FEDERAL STANDARDS in Docket No. G-999/CI-93-895⁷. In that Order the Commission indicated that it would convene a work group to develop a gas purchasing incentive scheme and a prototype incentive program for gas utilities. The Commission also stated that gas utilities in Minnesota need not wait for the outcome of the work group process; the utilities were encouraged to file a gas purchasing incentive proposal with the Commission.

Two days after the meeting at which the Commission made the decision to convene the work group, Minnegasco submitted its proposed GPI. To date, this is the only GPI proposal submitted to the Commission. Convening of the work group has been delayed, so that parties discussing GPI proposals need not be constrained by the necessity of avoiding rate case ex parte contact.

b. The Minnegasco GPI Proposal

The Commission has expressed its desire to explore the concept of a gas utility GPI. Because of the Minnegasco proposal's late filing and lack of specific information, however, the Commission is unable to adequately judge its merit. The Commission is also concerned by the substantive objections to the proposal raised by the Department, the RUD-OAG, and the ALJ. Finally, the late filing has not provided potential parties with the opportunity to provide comments, suggestions, or critiques.

For these reasons, the Commission will reject Minnegasco's GPI proposal. The Commission strongly encourages the Company to note the comments filed in these proceedings, including the RUD-OAG's suggested criteria, and, if available, any reports or suggestions from the work group. With this input, the Company will be better equipped to rework and develop the plan for a future filing. The Commission will be happy to consider a GPI submitted by Minnegasco in a fully developed form, with proper opportunity for comment and analysis afforded to all interested parties.

⁷ In the Matter of an Investigation into Standards Regarding the Encouragement of Investments in Conservation and Energy Efficiency by Gas Utilities under 15 USC 3203 as Amended by Section 115 of the Energy Policy Act of 1992.

XX. OVERALL FINANCIAL SUMMARIES

A. Rate Base Summary

Based on the above findings, the Commission concludes that the rate base for Minnegasco's test year is \$333,081,000 as shown below:

(000s)

Utility Plant in Service	\$ 635,889
Accumulated Depreciation and Amortization	<u>(289,307)</u>
	346,582
Gas stored Underground:	
Current	22,503
Non-current	997
Accumulated Deferred Income Taxes	(32,096)
Materials and Supplies	3,404
Cash Working Capital	(3,687)
Deferred Debits and Credits	(7,737)
Other Working Capital	<u>3,111</u>
 TOTAL RATE BASE	 \$ 333,081 <u>=====</u>

B. Operating Income Statement Summary

Based on the above findings, the Commission concludes that the appropriate Minnesota jurisdictional operating income for the test year under present rates is \$27,468,000 as shown below:

(000s)

Operating Revenues:	
Gas Sales	\$625,643
Other Revenues	<u>5,651</u>
Total Operating Revenues	631,294
Operating Expenses:	
Cost of Gas	454,969
Production and Maintenance	12,249
Distribution and Utilization	19,170
Depreciation and Amortization	28,715
 Sales and Customer Accounts	 18,482
Administrative and General	24,950
Customer Service and Information	6,479
Conservation Improvement	6,112
Taxes Other than Income	22,718
Federal and State Income Taxes	<u>9,982</u>
Total Operating Expenses	603,826
 TOTAL OPERATING INCOME	 \$ 27,468 <u>=====</u>

C. Gross Revenue Deficiency

Based on the Commission findings and conclusions, the Minnesota jurisdictional revenue deficiency for the test year is \$8,086,000 as shown below:

	<u>(000s)</u>
Rate Base	\$333,081
Rate of Return	<u>9.67%</u>
Required Operating Income	32,209
Operating Income	27,468
Income Deficiency	4,741
Revenue Conversion Factor	<u>1.7056</u>
Revenue Deficiency	<u><u>\$8,086</u></u>

ORDER

1. Minnegasco is entitled to increase gross annual Minnesota jurisdictional revenues by \$8,086,000 in order to produce total gross annual jurisdictional operating revenues of \$639,380,000.
2. The Commission accepts and adopts the Offer of Partial Settlement except for its treatment of manufactured gas clean-up costs.
3. The Commission modifies the Offer of Partial Settlement on the subject of manufactured gas clean-up costs to provide as follows:
 - a. The Company may include in test year expenses \$2.105 million in manufactured gas clean-up costs;
 - b. The Company shall use deferred accounting to record actual costs in excess of those authorized for recovery;
 - c. The Company shall record in a deferred credit account without carrying charges all insurance or other third party recoveries for clean-up costs.
4. Any party to the settlement who rejects the modification set forth above shall file a notice of rejection under Minn. Stat. § 216B.16, subd. 1a within ten days of the date of this Order.
5. The Commission accepts and adopts the resolution of every issue set forth in the Stipulation of Facts and Recommended Decision except the issue of funding FAS 106 obligations.
6. Within 18 months of the date of this Order, or by the time Minnegasco files its next rate case, whichever comes sooner, Minnegasco shall establish an external funding vehicle(s) for its future postretirement benefit obligations other than pensions. A VEBA trust fund shall be established to meet this requirement unless the Company demonstrates that this alternative is impractical or otherwise inappropriate. Deposits to the external funding

vehicle shall be made as soon as this type of funding can be achieved on a tax-advantaged basis.

7. Within 30 days of the date of this Order the Company shall file with the Commission for its review and approval, and serve on all parties to this proceeding, revised schedules of rates and charges reflecting the revenue requirement and the rate design decisions contained herein, along with the proposed effective date.

The compliance filing filed pursuant to this Ordering Paragraph shall contain:

- a. A breakdown of Total Operating Revenues by type;
 - b. Schedules showing all billing determinants for the retail sales of gas. These schedules shall include but not be limited to:
 - i. Total revenue by customer class,
 - ii. Total number of customers, the customer charge and total customer charge revenue by customer class, and
 - iii. For each customer class, the total number of commodity and demand related billing units, the per unit commodity and demand cost of gas, the non-gas unit margin, and the total commodity and demand related sales revenues.
 - c. Revised tariff sheets incorporating the rate design decisions contained in this Order.
 - d. Proposed customer notices explaining the final rates and a full explanation of the customer basic charge.
8. Within 30 days of the date of this Order, the Company shall file with the Commission and serve on the parties, a revised base cost of gas and supporting schedules incorporating the changes made herein. The Company shall also file its automatic adjustment establishing the proper adjustment to be in effect at the time final rates become effective. The Department shall review these filings as it does other automatic adjustment filings.
 9. Within 30 days of the date of this Order, the Company shall file with the Commission for its review and approval, and serve upon all parties to this proceeding, a proposal to make refunds, including interest calculated at the average prime rate, to affected customers. The Company's plan shall clearly explain adjustments to the CIP tracker balance and the adjustments for 1992 rate case expenses.
 10. Within 60 days of the date of this Order, the Company shall submit a compliance filing showing the calculation of the CIP CCRC based on final and interim rates approved by the Commission. Minnegasco's calculation of CCRC revenues collected during the interim rate period began February 1, 1994, and will end on the date that Minnegasco implements final rates.
 11. Within 60 days of the date of this Order the Company shall file the following information:
 - a. Minnegasco balance sheets for calendar years 1991, 1992, and 1993, prepared in accordance with generally accepted accounting principles;
 - b. cash flow statements for Minnegasco for calendar years 1991, 1992, and 1993, prepared in accordance with generally accepted accounting

principles and providing sufficient detail in every category to identify cash transactions between Minnegasco and NorAm.

- c. an explanation of NorAm's strategy for improving its capital structure, including the strategy's effect on dividend policy, and including NorAm's target equity ratios for the next three years.
12. Parties shall have 15 days to comment on the filings required in Ordering paragraphs 7 through 11.
13. Within 15 days of the date of this Order the Company shall submit a compliance filing showing a detailed calculation of the adjustment for leak calls that conforms with the Commission's leak call allocation decision. Minnegasco shall include, if practicable, the corrections to MAC's calculation and explain the specific items in MAC's calculation that Minnegasco believes are incorrect.
14. In its next rate case filing the Company shall include detailed explanations of and comparisons between the tax consequences of basing rates on NorAm's capital structure and the tax consequences of basing rates on Minnegasco's proposed capital structure. The Commission asks that parties to that case develop these issues fully.
15. In its next annual fuel report, the Company shall report on its efforts to lower its demand and commodity cost of gas.
16. In its next rate filing, the Company shall clearly show the components of inflation included in test year costs. If Minnegasco uses a projected test year in its next rate case it shall separate regulated from nonregulated costs in its historical data before projecting test year regulated costs.
17. Beginning on the date of this Order the Company shall record for future return to ratepayers all incentive compensation earned under the terms of its incentive compensation plan but unpaid.
18. In its next rate case filing the Company shall include a detailed description of any incentive compensation program it plans to implement during the period the proposed rates will be in effect. The Commission asks that parties to that case not settle any disputes between them in regard to issues surrounding incentive compensation.
19. The residential customer charge (renamed basic charge) shall remain at its current level, with the exception of the basic charge for former Midwest Gas customers, which shall be raised to the level in effect for other residential customers.
20. In the Company's next rate filing, the cost of gas leak checks in which no leaks are found shall be allocated between regulated and non-regulated operations based on the proportion of calls when a leak is found on either Company or customer owned equipment.
21. In its next rate filing, the Company shall submit a design for seasonal demand rates for informational purposes and a plan, including corresponding costs, for obtaining price elasticity data. The plan will include an estimate of costs to do a comprehensive study regarding seasonal demand rates, and will separately identify the costs of focusing on various customer classes.
22. In the Company's next rate filing the Company shall collect, if feasible, load factor and maximum daily use data for all of its C&I and SVDF customer classes.
23. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

(S E A L)